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The Development of Corporation Taxation in the State of New York

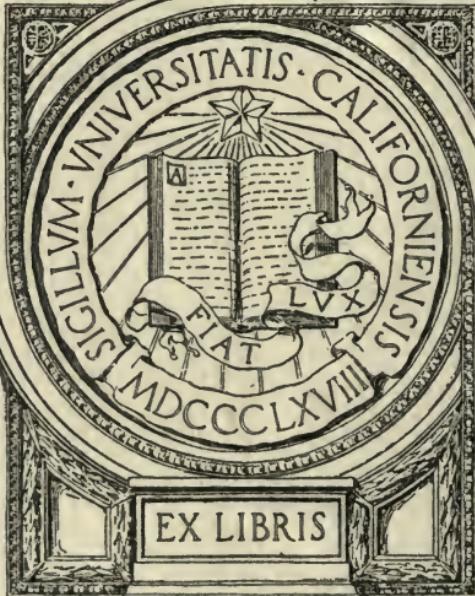
A THESIS

Presented to the Faculty of the Graduate School
of Cornell University for the Degree of
DOCTOR OF PHILOSOPHY



MERLIN HAROLD HUNTER

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THE DEVELOPMENT OF CORPORATION TAXATION IN THE STATE OF NEW YORK

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BY

MERLIN HAROLD HUNTER



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INTRODUCTORY NOTE

The purpose of this study is to trace in outline the development of the system of taxing corporations in the state of New York. Some consideration is also given to problems which have arisen under the present tax laws. Special emphasis has been put upon the legislative history of corporation taxes and upon the judicial interpretation of the statutes enacted. From among the great mass of statutes and court decisions bearing upon the subject I have tried to select the more important, and to discuss them in such a way as to show the general lines along which the tax system has developed. I have also tried to show, where possible, the more important influences which weighed with courts and legislature. The conclusions which have been drawn from laws, cases, and reports cited in the text are, in general, bolstered up by many which are not cited.

In the preparation of the study, I have been materially assisted by professor Allyn A. Young of Cornell University, under whose direction the work was done. Professor T. S. Adams of Yale University, Prof. C. O. Ruggles of Ohio State University, and Professor J. R. Turner of New York University have also given valuable suggestions. The services of others, who have assisted by reading the manuscript and proof, I wish also to acknowledge.

M. H. HUNTER

Urbana, Ill., September, 1917.



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CHAPTER I

THE GENERAL TAXATION OF CORPORATIONS BEFORE 1880.

DEVELOPMENT OF GENERAL PROPERTY TAX

It will be profitable to sketch briefly the general system of taxation in New York before a special tax was imposed upon corporations. We find that the personal property tax developed almost with the beginning of the colony.¹ Under the Dutch rule Peter Stuyvesant, as early as 1654, succeeded in having an "honest and fair tax" placed upon "land, houses or lots and milch cows or draft oxen." The tax was more highly developed on Long Island than elsewhere. During the English occupancy of the colony, 1664-1674, the Duke of York enforced a property tax upon Long Island, and when the Dutch regained ascendancy funds were secured by taxing the wealthiest citizens. This class included all who possessed more than two hundred dollars.

The results of these unsystematic attempts were only partially successful. After the establishment of the colonial assembly in 1683, the general property tax was developed in a more uniform way. The principle of assessing every person in proportion to his aggregate property was the fundamental rule. In the "tax and assessment" law of 1683—the first of its kind—provision was made

¹ For an excellent general history of these matters, see J. C. Schwab, "History of the New York Property Tax," *Publications of American Economic Association*, Vol. V.

for the election of assessors, the assessment of property, and the election of a treasurer. The method for disbursing the money raised was also included. Two of the difficulties of the general property tax soon appeared—dishonesty of officials, and incorrect and partial assessment of property. In less than ten years after the passage of the act the assembly appealed to the governor for some method of equalizing assessments. The interference of higher authorities, and the establishment of flat rates of assessment for different classes of property were used to improve matters. Fundamentally, however, the law remained the same throughout the eighteenth century, although various amendments indicate that the operation of the law was not thoroughly successful.

The property tax in New York was from the first couched in general terms, and hence was in principle a true "general property tax." In most of the other colonies certain specific objects of taxation were defined, and the value regulated by law.² Where land was taxed it was divided into different grades, and so were horses, cattle, etc. The necessity of holding land before being admitted to the full rights of citizenship, and the provision of the federal constitution forbidding states to levy export or import duties, were conditions which helped to tighten the grip of the general property tax. This tax became so thoroughly intrenched that when any new object of taxation appeared, it was inevitable that an attempt should be made to put it under the property tax. When the corporate form of organization began to become important, the problem of taxation naturally appeared to be one of merely extending the application of the general property tax.

EARLY TREATMENT OF CORPORATIONS

Before any general law relating to the taxation of corporations was enacted, there were a number of important developments in the policy of the state towards this problem. Turnpike and bridge companies formed by far

² In Rhode Island, Delaware and Maryland, as well as in New York, the general property tax was in force.

the largest proportion of early business corporations. Most of the laws granting charters to such companies contained regularatory provisions, which, while not imposing taxes, required certain payments from the companies.³

Before 1823 there was no law which specifically taxed corporations. The tax law of 1800, however, had provided that shares should be deemed personal property.⁴ The turnpike law of 1807 likewise declared the shares of such organizations to be personal estate.⁵ We have evidence, moreover, that corporations were taxed under the general property tax law. In the case of *The People vs Ithaca Insurance Company*,⁶ Martin Van Buren, Attorney General, cited the case of the *Clinton Woolen Manufacturing Company vs Morse and Bennett*,⁷ and said that in that case the opinion was given "that under the act for the assessment and collection of taxes⁸ corporations are liable to be taxed for property owned by them; yet the act speaks only of persons liable to be assessed and the term *corporation* is not used at all." Thus, in the first definite recognition of the corporation as an object of taxation, it seems to have been dealt with in exactly the same way as a natural person. Doubtless the litigation arising from this method of handling the problem was a factor leading to the passage of the law of 1823—the first statute dealing specifically with the taxation of corporations.

³ The first act of this kind was one creating the Quaker Hill Turnpike Company, (Chap. LXVI, 1802). It provided for inspectors to be appointed by the Governor, and paid by the company. Regulatory provisions are found in practically all laws granting such charters before 1807. In that year a general turnpike company law was enacted. This provided for the appointment of commissioners to lay out the road, the valuation of private property by assessors appointed by the county judge, and for commissioners to investigate the conditions of the road. All of these were to be paid by the company at specified rates.

⁴ New York Statutes, 1800, Chap. 79.

⁵ New York Statutes, 1807, Chap. 38.

⁶ *The People vs Ithaca Insurance Company*, 15 Johnson, 382.

⁷ This case was not reported. It was tried in the October term, 1817.

⁸ New York Statutes, 1813, Chap. 52.

THE TREATMENT OF CORPORATIONS BEFORE 1880.

The general tax law of 1823⁹ contained provisions which dealt specifically with the taxation of corporations. All incorporated companies receiving a regular income from the employment of capital were defined as "persons" within the meaning of the act, and were to be assessed and taxed in the same manner as individuals. The secretary or treasurer of the company was to deliver to the assessor in the town or ward where the office or place for transacting the business was located, a list showing the real estate occupied by the company, the amount of capital actually paid in or secured to be paid in, except the amount invested in real estate, and the amount of stock held by the state or any charitable or literary institution. The proper officer of the company was to pay the tax, and deduct it from the dividends of stockholders in proportion to the amount of stock held by each. No deduction was to be made in case of stock held by literary or charitable institutions. The tax might be commuted into an income tax, if the company so desired, by a direct payment into the county treasury of ten per cent of all dividends, profits or income, in lieu of any tax levied upon the property.

The funds received from the corporation tax were to be distributed through the state treasury. The total receipts were paid over to the state, the state tax was then deducted, and the remainder was credited to the counties in proportion to the aggregate amount of stock held or owned by stockholders residing in them. To enable the state treasurer to make the proper apportionment, the proper officer of every corporation liable to taxation was required to furnish annually to the state treasurer a list of the names of the stockholders in the company, their places of residence, and the amount of stock held by them. The state treasurer then sent to each county a list of its stockholders, places of residence, the amount of stock held by each, together with the amount of tax accredited to the county. Provision was further made for the distri-

⁹ New York Statutes, 1823, Chap. 262.

bution of the money to the several cities and towns in proportion to the aggregate amount of stock held therein. The purpose of the law, it stated, was to achieve the result that would have been reached had the stockholders been originally assessed on their holdings at the place where they lived.

This first statute was fought in the courts from various angles. Some of the decisions narrowed its application, and others led to supplementary legislation. The question whether this law superseded all prior statutes was one of the first to be settled. In 1817 a law had been passed to encourage manufacturing in the state which exempted from taxation the buildings, machinery and manufactured products in the hands of manufacturers of cotton, woolen or linen goods.¹⁰ In 1827 the property of the Columbia Manufacturing Company was sold for taxes. Action was brought in the courts on the basis of the law of 1817. In its decision the court held that the law of 1823 was a revision of all taxation laws and superseded all previous legislation.¹¹

This decision made the law of 1823 the basis for future legislation. As interpreted by the court it was to be applied to all corporations without exception. Evidently it began to work hardship upon roads or at least to curtail their extension, for in 1825 exceptions were made in some particular cases.¹² If the *net income* or profits of turnpike, bridge, canal or manufacturing companies did not exceed five per cent on their capital stock they might commute their property taxes by paying five per cent of all profits or income directly to the county treasury. The legislature in 1827-28 made some slight changes, the most important being a provision that if *any* incorporated company could show to the satisfaction of the board of supervisors that the company had been in receipt of *no* profit or income, it should be stricken from the assessment roll, and no tax imposed.¹³ Turnpike, bridge, and canal com-

¹⁰ New York Statutes, 1817, Chap. 64.

¹¹ 4 Cowen, 556.

¹² New York Statutes, 1825, Chap. 254.

¹³ New York Statutes 1827, Chap. 9, and revised Chap. 13, title 4, sects 11 and 12.

panies were treated more leniently than before in that if their net annual income did not exceed five per cent on capital stock, they were exempt from taxation. Marine insurance companies were added to the list with commutation privileges. The law of 1823 had made no attempt to classify corporations, but in these modifications we have a distinct recognition of the principles of classification. In other respects the law remained unchanged for a number of years.

The commutation provisions in the above laws are interesting in the light of present income taxation discussion. They might easily be taken to indicate that the legislature viewed the property tax as a tax on ability to pay. It appears that it was viewed as a sort of income tax, and where it obviously failed to function as such a tax, it was modified. We shall see a little later, however, that the courts disclaimed any such intention on the part of the legislature.

The laws had not yet established a hard and fast view of the legal nature of a corporation. This led to some interesting developments in both case and statute law. The bank of Ontario had been chartered in 1815 and was taxed under the general law of 1813,¹⁴ until the law of 1823 was enacted. In the early thirties the village of Ontario placed an assessment against the bank. It entered a demurrer on the ground that it was neither an inhabitant nor freeholder, and only such could be assessed. The Supreme Court held that the term "inhabitant" included corporation, and that the assessment was valid.¹⁵ For purposes of taxation, then, a corporation was a person and an inhabitant. But there were problems still unsolved.

The bank of Ithaca had been notified by one King, the road supervisor, to appear at eight o'clock on a certain morning to work forty-nine days on the highways. The bank did not appear, either in person or by substitutes,

¹⁴ New York Statutes, 1813, Chap. 52. This stated, as in previous laws, that shares were to be assessed in the hands of the stockholders.

¹⁵ *Ontario Bank vs Burnell*, 10 Wendell, 186.

nor did it proffer a commutation payment. A justice fined the bank forty-nine dollars whereupon the bank carried the case to the Supreme Court which decided in its favor.¹⁶ A corporation, the court held, has no corporeal body; *it has no material existence*; it is incapable of performing labor and cannot be compelled to perform an impossibility. Hence it was not liable to assessment to work on a highway. When the performance of labor is required, then, a corporation loses its personality. But the legislature took a hand in the matter by enacting, in 1837, a statute which was very likely inspired by this decision.¹⁷ It provided that the commissioner of highways, after assessing at least one day's work on each male inhabitant above twenty-one years of age, "Shall include among the inhabitants of each such town, among whom such residue is to be apportioned, all moneyed or stock corporations which shall appear on the last assessment roll of their town to have been assessed therein." The corporation was to be notified of the amount of labor assessed against it by a written notice to its officers, and any number of days' work not exceeding fifty could be required in any one day. The same provision was made for commutation as was made for individuals. Corporations were thus re-established as persons, even for working on the highways.

Other questions soon came before the courts. What for example, was the precise meaning of the provision that a company would not be taxed if it could show that it had received no profit or income? Were profit and income synonymous terms, or did the law intend to distinguish between them? If they were merely two terms for one thing, then *net income* must have been intended. Some companies held to this view, and refused to pay a tax because they had no clear income. Some assessors, on the other hand, took it that gross income was meant. These difficulties of course led to litigation.

As representative cases we shall note those of the Com-

¹⁶ *Bank of Ithaca vs King*, 12 Wendell, 390.

¹⁷ New York Statutes, 1837, Chap. 431.

mercial Insurance Company,¹⁸ and one involving two Niagara banks and a railroad company.¹⁹ In the first case the company asked to be stricken from the assessment roll since it had been in receipt of no property or income, and because the value of its property during the year had not equaled the stock paid in. The request was refused, and a tax of \$1320 was levied. The court held that the tax must be paid, for the principle had never been advanced that the taxation of property depended upon whether it was profitably used or not. No such distinction was made in taxing the property of individuals—in fact to make it, would be to tax the skill and industry used in employing capital instead of taxing capital itself. The court quoted a letter written by the Comptroller to the assessor in 1826 in which the same view was taken.

The point at issue in the other cases was similar. One of the banks, because of depreciation of state stock and other causes, had suffered a loss to an amount exceeding its whole income or profits. The other bank's condition was practically the same. The railroad company had devoted all receipts to necessary expenses, repairs, and improvements, so it had no profits or income beyond what had been thus absorbed. As in the other case the court decided that these assessments stand. An individual was taxed on the value of his estate, even though it be so managed as to prove a charge upon him instead of a source of profits. Since railroads were to be assessed and taxed, not as operating units but as separate parcels of property in the different towns through which they passed, the court held that this part of the law did not apply to railroads which would be subject to tax even though no profits or income had been received. The personal nature of corporations was emphasized, and the general property tax was rigorously applied.

In the case of banks it might easily have happened that the original capital had been reduced through losses. Were banks in such cases to be assessed on the amount of capital paid in, or secured to be paid in, or only upon

¹⁸ *People vs Supervisors of New York*, 18 Wendell, 605.

¹⁹ *People vs Supervisors*, 4 Hill, 20.

the amount left after losses were deducted? Could surplus and individual profits be assessed and taxed as property? Both of these questions came before the courts for settlement. In the case of the Farmers' Loan and Trust Company²⁰ losses had reduced a capital of \$200,000 to \$104,000. The bank was assessed upon the original amount and refused to pay. The court, after a lengthy discussion, held that a corporation should be assessed upon the whole nominal amount of capital paid in, or secured to be paid in, and that no deduction was to be made for losses of capital, or for debts. It further held that no deduction could be made for that part of the capital which might be invested in the stock of other corporations liable to taxation. This was afterward recognized by the legislature to be double taxation, and the law was amended accordingly. The Attorney General, in 1832, had held that since individuals were permitted to deduct debts from their personal property assessments, inter-corporate holdings should not be subject to double taxation.²¹

The Bank of Utica had been taxed on \$70,000 surplus, which was described on the assessment roll as "other personal property or surplus." The court²² reversed the action of the assessors. A corporation could not be taxed on surplus profits remaining on hand and undivided. The capital stock, after deducting the value of the real estate, was the basis for taxation. Taxing surplus would amount to taxing the actual rather than the nominal value of the stock, and this the legislature did not intend. This decision, however, was not a final settlement of the matter. It opened the way for evasions of various sorts, and the problem continued to occupy the attention of the legislature and the courts.

We have seen that no deductions for taxes were to be made from dividends on stock owned by the state, or a charitable or literary institution. It appeared, however,

²⁰ *Farmers' Loan and Trust Company vs Mayor of City of New York*. 7 Hill, 261.

²¹ Report of Attorney General, Senate Documents, 1832, Vol. 2, No. 103.

²² *Bank of Utica vs City of Utica*, 4 Paige, 399.

that this provision worked to the advantage of the corporation while it was of little benefit to the state or charitable institution which might own its stock. A statute was accordingly enacted in 1845 which required the corporation to add to the dividend paid on tax exempt stock, a sum equal to the taxes paid on the same amount of stock not exempt from taxation.²³ Thus the total tax burden upon the corporation was not decreased, but part went to the favored stockholders.

These were the principal ways in which the law of 1823 was developed and modified by the courts and the legislature. The method of taxing corporations thus established remained until 1853. Corporations were no longer looked upon, as in the law of 1813, as an actual group of natural persons, but as an abstract, immaterial thing, created by law, and deriving its powers from the law.

The growth of corporations had made them of increasing importance as property-owning factors, and hence as objects of taxation. The expenditures of the state, however were rapidly becoming greater than the revenues.²⁴ In the Comptroller's report of 1849, the legislature was urged to observe the most rigid economy in making appropriations. Rather than burden the people with more taxes, he wished to retrench all unnecessary expenditures.²⁵ Expenditures, however, continued to grow and more revenue had to be secured. One way to obtain the needed funds was to put a heavier tax burden upon corporations. This is at least a partial explanation of the important statute of 1853, amending the general tax law. The desire to introduce a larger measure of system and uniformity into the corporation tax seems to have been another factor.

In the first place, by the law of 1853,²⁶ the total exemption of that portion of capital represented by surplus or

²³ New York Statutes, 1845, Chap. 195.

²⁴ The tax collected from corporations in 1843 was \$381,372.89. Annual report of State Comptroller, Assembly Documents, 1844, Vol. 3, No. 98.

²⁵ Annual Report New York State Comptroller, 1839, p. 4.

²⁶ New York Statutes, 1853, Chap. 654.

undivided profits was done away with. It provided that the assessment roll should contain not only the amount of capital stock and the amount invested in real estate; but also the amount of all surplus profits or reserve funds exceeding ten per cent of the amount of capital stock left after deducting for real estate and for the amount of stock owned by the state or charitable institutions. In the second place, the provision for the commutation of the property tax into an income tax, which had already been granted to turnpike, bridge, and marine insurance companies, was made general. If any corporation had not received net annual profits or clear income equal to five per cent of the capital stock, after deducting the assessed value of the real estate, it could exempt itself from the capital stock tax by paying, directly to the treasurer of the county where the business was conducted, five per cent of such net profits or income as it did receive, together with the taxes levied on its real estate. The law further stated that the capital stock of every company liable to taxation, except as exempted, together with its surplus profits or reserve funds exceeding ten per cent of the capital (less the real estate value) together with the real estate should be assessed and taxed in the same manner as the personal and real estate in the county. This latter provision, as modified in 1857, remains the fundamental part of the system of corporate taxation for local purposes. Corporations are taxed locally on their real estate, and upon their capital stock as here provided.

This law, it is important to note, introduced a uniform taxing system applying to all corporations. But new exemptions were made almost at once. From the first, roads and turnpike companies had been especially favored by the law makers. Because of competition from other routes of travel, this was a particularly bad period for turnpike companies, and in 1854 special legislation was enacted in their behalf.²⁷ Toll houses, fixtures, and all property were exempted from assessment or taxation until the net annual income over and above all expenses of repairs and collection of tolls exceeded five per cent on

²⁷ New York Statutes, 1854, Chap. 87.

the original cost of the road. In the next year²⁸ the net annual income allowed before taxes could be imposed was raised to seven per cent, while the accumulation of a "suitable reserve fund" was allowed as part of the expenses which might be counted against income. The loopholes in such legislation are apparent, and it is not surprising that revenue from these sources was small. Moreover, the laws did not provide for the systematic collection of taxes, or for any definite way of dealing with companies which refused to pay them. Each county handled the situation in its own way and much revenue was lost to the state. Many corporations went into insolvency before their unpaid taxes had been collected. Successive State Comptrollers asked that the laws be simplified, that more explicit directions be given to assessors, and that it be made the duty of county treasurers immediately to prosecute corporations which were in arrears.²⁹

As long as commutation of taxes was permitted only to highways and insurance companies there was little complaint, but as soon as it was made general the evils of the system became apparent. This matter seems to have had a larger importance than has sometimes been attached to it.³⁰ State Comptrollers and various committees condemned the commutation provision and asked for a change.³¹ It is obvious that commutation was inconsistent with the principles of the general property tax. The purpose was to tax corporations like individuals, but no similar privileges were granted to individuals. There may be proper reasons for putting corporations under a

²⁸ New York Statutes, 1855, Chap. 546.

²⁹ The Comptroller's report for 1854 (Assembly Documents, 1855, Vol. 1, No. 4) was especially urgent along these lines. The reports for several succeeding years ask for the same relief.

³⁰ Professor Seligman (Essays in Taxation, New York, 1913, p. 147) says that it seems few corporations ever availed themselves of this doubtful privilege of commutation, and accordingly in 1857 the law was changed.

³¹ The report of the Finance Committee (Senate Documents, 1857, Vol. 2 No. 55) and the Comptroller's report (Assembly Documents, 1857, Vol. 1. No. 7.) were particularly bitter against the commutation provisions.

special rule as regards taxation yet the lack of profits is hardly a sound basis of discrimination in favor of this form of business organization.

Not only was the law defective in principle, but it gave opportunity for fraud. Commutation and exemption were secured in violation of the intent and spirit of the law. Affidavits accompanying application for exemption were artfully worded so that some companies which realized an income of more than five per cent, perhaps double this, escaped or nearly escaped taxation. *Loss* and *expense* were words which were juggled with to cover up actual earnings. *Expense* often included money spent for fixtures, property, and other permanent improvements not properly chargeable to annual operating expenses. A heavier tax burden was thus shifted to individual tax payers. Such were the conditions painted by those who recommended a revision of the law. The change was accomplished in 1857.³² Besides abolishing the commutation privilege the law permitted the amount of stock owned in another corporation subject to the tax to be deducted from the amount of capital stock put upon the assessment roll. This provision attempted to eliminate the double taxation formerly inherent in the operation of the law.

But this law as revised was anything but definite, and consequently caused much litigation. What was meant by actual value of the stock? When was there a surplus? Was stock invested in United States securities exempt from taxation? Was property temporarily outside the state subject to assessment? These and many other questions were left to the courts for interpretation.

But a few of the representative cases can be noted. The Oswego Starch Factory sought to decrease its taxes by distributing all earnings to the shareholders, so that no profits or surplus remained. A fifteen per cent dividend had been declared, consequently the stock had been assessed at seventy-five per cent above par. The company carried the matter to the Supreme Court, and then to the Court of Appeals. The Court of Appeals affirmed the

³² New York Statutes, 1857. Chap. 456.

action of the lower court by holding that for the purpose of taxing corporations under the law of 1857, stock was to be assessed at actual value, whether above or below the nominal par value, and this irrespective of the existence of surplus capital or reserve.³³

Some corporations refused to pay taxes upon that part of their capital stock which they had invested in United States securities, on the ground that the constitution forbids the taxation of the federal debt. The courts, in different cases,³⁴ took the opposite view. The state assessment was, they held, not in form merely, but in fact and principle, upon the capital stock of the corporation and not upon the property in which the money paid in for that capital was invested. There could be no objection to the state's taxing capital invested in United States securities as long as there was no unfriendly discrimination against the United States as a borrower, and as long as the property in stock of corporations holding United States bonds was subjected to no greater burdens than property in general.

Steamship companies attempted to gain exemption on capital invested in ships which either were being constructed or were registered outside the state. This made it necessary for the courts to decide what effect the situs of the property of a corporation had on its liability to taxation. In two cases, one decided by the Supreme Court,³⁵ and the other by the Court of Appeals,³⁶ the status of such property was determined. The property of a corporation need not be physically within the state to be taxable; if legal situs and ownership be so situated it is taxable. The only provision for taxing corporations was to assess the capital stock at actual value without regard to the kind or situs of the property in which it was invested.

³³ *Oswego Starch Factory vs Dolloway*, 21 N. Y., 499.

³⁴ *Bank of Commonwealth vs Commissioners of Taxes and Assessments*, 32 Barbour, 509 and 23 N. Y., 192 give in detail the attitude of the courts on this point. For cases relating to it in the United States Supreme Court see Chapter VI. p. 97.

³⁵ *People vs Commissioner of Taxes*, 3 Thompson and Cook, 678.

³⁶ *Pacific Mail Steamship Company vs Commissioner of Taxes*, 64 N. Y., 541.

Such, then, was the law by which corporations were to be taxed for the next several years. No longer were corporations looked upon as public benefactors, deserving special encouragement and more lenient treatment than natural persons, but all were taxed alike under practically the same rule.³⁷ The same assessors and the same methods of assessment served for the man with the small farm worth \$1000 and for the corporation worth \$1,000,000. As yet, however, neither legislators nor judges had held that the corporate form gave any special advantage for which remuneration should be made, nor was it argued that under uniform legislation in taxation, the corporations might have advantages that did not accrue to individuals.

This system of "uniform treatment" was not however, entirely satisfactory. In practically every successive annual report of Comptrollers, reform measures were proposed to the legislature. One of the first evils to be emphasized was the perennial lack of uniformity in local assessment methods—a fault which was brought into glaring relief by the differences in the assessment of similar corporations. Local assessors had to appraise the real estate and the "personalty" of even the largest corporations. True values were easily covered up, and in any case the assessor rarely was competent to value corporate property correctly. In some districts the corporations were assessed and taxed to the full value of capital and surplus, while in others the assessment was as low as twenty-five per cent of the actual value. This evil was an inevitable part of the system.

The use of different systems of equalizing valuations led to further injustice. Not only did special districts take advantage of the law for their own good, but corporations often designated as the place of the principal office,—where the assessments were to be made,—some district where the corporation was unknown to the assessor, or where the actual plant was so far away that the assessor had no way of getting at real values. Such were the

³⁷ Some concessions, however, continued to be made to banks and insurance companies.

evils which the Comptrollers continued to emphasize and for which they asked legislative remedies.

The remedies proposed were for the most part mere palliatives. No Comptroller even hinted at the possibility of radical change in the law,—of the abandonment of the attempt to apply the general property tax in its crude form to corporations. It was urged that returns should be subjected to the inspection and decision of one person. This would insure uniformity in the mode of determining valuations as well as more reliable data than could be had by local assessors without access to reliable sources of information. The central valuations, it was proposed, could be sent to the counties, and then put upon the district assessment rolls. The listing system was also proposed, by which every taxpayer was to furnish to the assessor, under oath, a detailed statement of all his property liable to taxation together with its value. This system was used in several of the western states, and, it was alleged, with success. In order to secure uniformity in the assessment of real estate, it was considered advisable to have state assessors visit every town and ward in the state, and ascertain from personal observation and investigation, the true and actual value of all real estate. These valuations were to be turned over to a state board of equalization, and their returns distributed to the counties by the comptroller. This would insure that a large amount of real estate which had escaped taxation would be placed upon the rolls, and would also give a more equal valuation than would the old haphazard way.

It was not until 1870 that the legislature took any action. Provision was made, in that year, for a special tax commission, to report in 1871. An exhaustive review of the system of taxation was given by the commission, its evils were pointed out, and remedies were suggested.³⁸ It emphasized the tax dodging resulting from the exemp-

³⁸ The report of this commission is given in Assembly Documents, 1871, Vol. 3, No. 39. The commissioners were David A. Wells, Edwin Dodge and George W. Cuyler. This report has become famous, and is by far the best treatment of the New York tax system that we have. A second report was made in 1872 (Senate Documents, 1872, Vol. 2, No. 26.)

tion of federal securities, and even went so far as to say that from the standpoint of taxable resources it was a fortunate matter that so many of these securities had fallen into the hands of foreigners. United States bonds were often used as collateral upon which to borrow money. One who had \$100,000 in bonds might borrow \$100,000 and invest it in business. When assessed, the return would be \$100,000 business capital, \$100,000 just debts and liabilities, no personal property subject to taxation. For example, the fire insurance companies of New York City, with a capital of about \$24,000,000, and an estimated surplus of \$11,000,000, making a total of \$35,000,000, were assessed in 1870 on a personal property valuation of \$9,240,965 and a real estate valuation of \$3,000,000.

The suggestion made aimed largely at a more uniform application of the general property tax to the corporate form of industry. The commission advocated, however, a special tax upon corporations which enjoyed monopoly privileges, and cited several instances of such conditions. In spite of the thoroughness of the work and the vividness with which evils were portrayed, the recommendations failed to bring about any reform. Reasons for this, which no doubt may be considered largely true, were given by the *New York Times*. It said editorially: "The commission appointed in 1870 was barren of practical results, partly, we suspect, because the changes suggested involved something like thoroughness in the work. Local opinion was not ripe for them and local politicians were unwilling to undertake the task of educating their constituents up to the mark at which comprehensive legislation might be possible."³⁹

It was not until 1876 that the legislature was again moved to the point of taking further action. In that year the Assembly adopted a resolution⁴⁰ to the effect that a commission be appointed to prepare a bill relating to assessment and taxes to be presented to the next legislature. The resolution suggested certain reform measures to be incorporated in the bill. One of these was that corpora-

³⁹ *New York Times*, April 15, 1879.

⁴⁰ Assembly Documents, 1876, Vol. 6, No. 105.

tions and joint stock companies should be assessed and taxed by state assessors. The assessment should be based upon a percentage of gross receipts, upon the value of shares in proportion to dividends, or in any other manner that seemed just and equitable. The rate was to be graduated according to investments in real estate while no deduction was to be made for such investments. It was further suggested that manufacturing companies be assessed at a low figure, that real estate continue to be assessed where located, and that all corporation taxes except on real estate be paid directly to the state treasury. Here were suggestions for real reform, and at least a hint of the possibility of using some method other than the general property tax. But nothing resulted from the resolution, and the Comptrollers continued to inveigh against the then existing methods of taxation. The reports of Comptrollers from 1875 to 1880 are practically unanimous in their condemnation of the evils which existed. Because of the high rate of taxation in some places, the employment of capital had become unremunerative. A continuance of such a policy spelled ruin. As a whole, however, the personal property of corporations was very much underassessed. The assessment of real estate, it was pointed out, might approximate its real value, because it forced itself upon the notice of the assessors, but personal property could escape because it was so easily concealed or moved. To prove the contention, figures were cited to show that the assessed value of personal property had actually declined from year to year.⁴¹

In their report for 1876⁴² the State Assessors asserted that the assessment of the stock of incorporated companies, as generally practiced, was no more than a mockery. The working of the law, in their opinion, had reached a point from which a new departure was dispensable. In their report for 1878⁴³ they expressed a surprise and in-

⁴¹ Annual Report of New York State Comptroller, 1879.

⁴² Annual Report of New York State Assessors, Senate Documents, 1879, Vol. 2, No. 28.

⁴³ Annual Report of New York State Assessors, State Documents, 1879, Vol. 2, No. 28.

dignation that legislators into whose hands great trusts had been committed, and who were supposed to guard the welfare of the people, could longer refuse to grapple with the tax laws and either amend them so as to make them uniform in their purposes and operation, or change the system so as to confer the greatest good upon the greatest number. They even advocated the collection of all state taxes (except what would be necessary for the state capitol then in construction and in which the people would want to have a share) from domestic and foreign corporations doing business in the state. This latter suggestion is closely akin to the present much discussed reform of separation of state and local revenues. But it seemed impossible to impress the urgent importance of tax reform upon the minds of the legislators.

In 1879 the legislature seems to have been somewhat aroused from its lethargic attitude but no positive accomplishment was reached. As expressed editorially in the *New York Times*, the legislature merely "showed a disposition to do something."⁴⁴ Beginning with 1879 the newspapers of the state began to give more attention to taxation matters. The *Times* showed how corporations were evading taxation by investing capital in nontaxable securities, by locating the principal office in districts of low taxation, and by other devices.⁴⁵ It was claimed that for years the influence of railroads and other corporations had been powerful enough to defeat all efforts to compel them to bear their just proportion of public burdens. The legislature, throughout the session, was criticized because of inactivity, and because of its apparent unwillingness to do anything with the tax situation. Just before adjournment the *Times* said editorially:⁴⁶ "The point has been reached at which shadowy indications of a willingness to correct the flagrant evils of the present system of taxation and to substitute for it a system at once equitable and productive, will no longer suffice. Year after year the evils have been heard off, the demands now is for

⁴⁴ *New York Times*, April 21, 1879.

⁴⁵ *New York Times*, January 16, 1879.

⁴⁶ *New York Times*, April, 21, 1879.

effective remedies. It is admitted that these cannot be hoped for this year and it is all but certain that for the clumsy expedients now before the legislature there is no chance. All that members who honestly desire reform recognize at the moment possible is some indecisive action or some general expression of opinion that shall seem to strengthen the likelihood of obtaining legislation next year." This well expressed the situation:—an aroused public demanding reform, the hostile attitude of state officials to the existing system, and the partial awakening of the legislature to the need of reform.

Under these circumstances, the legislature could not well resist much longer. Among the first things it did in 1880 was to attack the tax situation. A joint committee was chosen to revise the tax law. Through the efforts of this committee, the pressure brought to bear by the public, and through the interest of certain individual law makers, a new tax law was finally passed. This law is the basis of the present general system of taxing corporations for state purposes.

CHAPTER II.

THE ANNUAL FRANCHISE TAX UPON CORPORATIONS

The present annual franchise tax upon corporations is based on the statute enacted June 30, 1880,¹ It introduced the indirect system of taxation for state purposes which has since been largely followed. No change, however, was made in the method of taxation for local purposes.

Under this law every corporation was required to report annually to the State Comptroller, the amount of capital stock paid in, and rate per cent of every dividend declared during the preceding year. If there should be no dividend, or should the dividend be less than six per cent, on the par value of the stock, the company was to furnish an estimate of the actual value of the capital stock. This value must not be less than the average price at which the shares had sold during the preceding year. If the comptroller was dissatisfied with the report he was empowered to make a revaluation. Penalties for neglect to make reports where provided while two successive failures furnished ground for proceeding to forfeit the corporation charter.²

The law further noted the exceptions and formulated the rule by which taxes were to be computed. Banks, savings banks, life insurance companies, foreign companies, and manufacturing companies did not come under the provisions of the act. The tax was to be computed as follows: If the dividends amounted to six per cent or more upon the par value of the stock, the tax was to be one-fourth of a mill for each per cent of dividend so made

¹ New York Statutes, 1880, Chap. 542.

² The penalty for failure to furnish the required report was an addition of ten per cent to the tax levied on the corporation for each year the report was not furnished.

or declared. If there were no dividends, or if they were less than six per cent, then the tax was to be one and one-half mills per dollar on the valuation of the stock as provided for above. Should a part of the stock pay more than six per cent, as preferred, this was to be taxed at the one-fourth mill rate, while the rest, if its dividends were less than six per cent, was to be taxed at the other valuation.

The taxes collected under this law were to be used for the ordinary expenses of the state. In 1881,³ to meet constitutional difficulties, the new tax was defined as a tax upon the corporate franchise or business of such organizations as came under the law. In 1882⁴ the powers of the Comptroller were extended. If he were dissatisfied with the report of a company only a part of whose capital was employed in the state, he could determine the amount of capital which should be taken as the basis of the tax. If the corporation were dissatisfied it could appeal to a board composed of the Secretary of State, the State Treasurer and the Attorney General, the decision of which was to be final. Broader powers were also given to the Comptroller in dealing with corporations which were delinquent in making reports.⁵

This was the first tax reform dealing with corporations in a quarter of a century, and a period, too, marked by the expansion and development of large scale business, and the corporate form of organization.⁶ Yet the reforms met with much criticism. The press, of which the *New York Times* will again be taken as representative, was anything but favorable. It characterized the whole result of the arduous and well-meant labors of the

³ New York Statutes, 1881, Chap. 151.

⁴ New York Statutes, 1882, Chap. 151.

⁵ The Comptroller was given power to examine the books and records of the company and to fix the amount of the tax. If the company failed to pay the tax and expense of examination within thirty days they could be sued. Witnesses and officers might be subpoenaed and examined under oath. Should they fail to appear they were guilty of contempt.

⁶ The provisions for taxing the corporations exempted from the action of this law will be given in the chapters dealing with such organizations.

joint committee as "an incongruous patch work", and said that the tax laws remained as much as ever in need of systematic and judicious revision.⁷ It prophesied that the "short-sighted bungling of the last legislature" would give the courts more to do than the tax collectors.⁸ The difficulty most emphasized was adjusting the annual franchise assessment to the assessment which had just been completed. This difficulty, of course, could be, at most, only temporary. Even the Governor had some misgivings for he is quoted as having said in a memorandum filed with his approval of the act that "for want of perfect and comprehensive provisions it [the act] may fail to accomplish all that it was evidently intended to do."⁹ He did not deem the objections of sufficient importance to warrant the withholding of his approval from the law, but the defects, he thought, should be remedied by the next legislature.

Much difficulty was experienced in attempting to apply the new law. The experiment, however, though imperfectly tried, had demonstrated the possibility of relieving the burden put upon real estate by the use of such a tax for state purposes. What was now needed was to make the law more serviceable. Suggestions to accomplish this were made to the legislature in 1881, but it could be induced to make no changes in the tax reform of the previous year.

The attitude of the Comptroller and State Assessors to the law was on the whole favorable, although they did not consider it free from objections. In the first Comptroller's report following the passage of the act, it was shown that the new law followed, in part, the Pennsylvania system, but that, as always must be the case when only a part of a complete system is adopted, the result could not be entirely satisfactory.¹⁰ The report further

⁷ *New York Times*, Editorial, May 29, 1880.

⁸ *New York Times*, Editorial, July 15, 1880.

⁹ *New York Times*, Editorial, July 31, 1880.

¹⁰ Annual Report of New York State Comptroller, Assembly Documents, 1881, Vol. 1, No. 3. The Comptroller had been one of the Commission appointed to investigate the Pennsylvania system and had worked energetically to have it adopted by the legislature.

showed that the Pennsylvania system was practically a separation of state and local revenues. This method was not well understood by the legislature, neither did they give it careful study, and it was defeated because of the radical character of the innovations it would have introduced. While he considered the attempt of the legislature an improvement, yet the Comptroller asked that a committee be appointed to work out a system more like that of Pennsylvania. Such, he thought, would not only work admirably in New York, but would simplify the problems of corporation taxation.

The report of the State Assessors was somewhat more optimistic, although they too saw serious difficulties in the way of the operation of the new law. It was, they thought, a step in the right direction, and with the proper amendments would amount to a very substantial improvement. If the personal property of corporations as well as of individuals could be made to bear a fair and equitable share of the public burdens, the taxation problem would be in large measure settled. They attributed the corporate influence to prevent tax legislation to the fact that existing inequalities would be perpetuated. Had the law been drawn so that the method of assessment would have been uniform and equitable, no just ground for complaint would have existed.¹¹

In all this comment on the part of officials and of the press, the principle set forth in the law of 1823—that corporations are persons and should be taxed as such—was given most importance. The difficulties that had arisen were bound up with the problem of valuing the property of the larger interests so as to secure just and equal treatment. But in the report of the State Assessors for 1881 we see the dawning of some new and exceedingly important ideas in respect to the general principles of corporate taxation. The assessors begin to suspect that perhaps something more than absolute equality in assessment and taxation is required if exact justice is to be done. After the personal property and real estate of a corpora-

¹¹ Annual Report of New York State Assessors, Senate Documents, 1881, Vol. 1, No. 40.

tion is fairly taxed with similar possessions of individuals, there is yet in the corporate hands a peculiar species of property,—the corporate franchise. This is a privilege, they contended, granted by the community as a whole to the corporation, and varies in its character and in its value: They pointed out three sources of franchise values: (1) the partial exemption of the owners of the corporation from ordinary business risks by limitation of liability; (2) the facility with which equities in corporate property may be transferred; (3) the value arising, in the case of some corporations, from their possessions and use of public property. These values had long escaped taxation and the new law was but a step in the right direction. They contended that franchise values should be justly and equitably assessed, and that such public grants might justly bear a high rate of taxation. The only limit to such taxation would be in a rate which would substantially check corporate enterprise or drive it from the state. Nothing in the present methods of taxation had produced such an effect, since the use of the corporate form of organization had steadily grown even in states where the tax was heavier than in New York.

The assessors granted the law to be an improvement over former methods yet suggested changes which would secure more revenue and greater equity. The act was criticized because it made no provision for taxing the valuable privilege conferred in permitting a corporation to be formed, and an organization tax was suggested as a remedy. As a payment for this privilege a tax was proposed of one mill per dollar on the capital stock of every new corporation (with a minimum tax of \$100). It was estimated that this would yield \$50,000 a year, while it would be collected more cheaply and paid more cheerfully than any other tax. It was also contended that more substantial justice should be secured in classifying the franchise values, especially among public service corporations.

In spite of the defects the assessors were pleased with what the law had accomplished since it had been in force. They said: "Under the operation of these laws over

\$1,000,000 have already been saved to the other tax payers of the state. The prospect is pleasing for more equal and less taxation. The last two years witnessed a great advance toward a just and exact system of taxation. The burden on the shoulders of toil has been lightened while at the same time capital has not been denied its rightful returns or enterprize deprived of its legitimate reward. The state tax has been greatly reduced and this too without hinderance or delay to the great works of public consequence that have given and continue to give New York State the lead in the procession of states.¹²

After the law really got into operation it seems to have been more favorably looked upon than when it first came from the hands of the makers. The lowest general tax rate since 1856 was in 1882, and this was attributed to the working of the new franchise tax on corporations.¹³ It was thought that this low rate could be maintained and that, with a few amendments to the law, in a few years the entire expenses of the state government could be secured without levying any state tax upon the counties.¹⁴

The new law, gave rise of course, to a number of disputes which the courts had to decide. The general result of this litigation was to more firmly establish the law. We shall note but a few decisions. The most important case was that of *The People vs The Home Insurance Company of New York*.¹⁵ The insurance company contested the constitutionality of the law on two grounds. First, because in a tax law the object of the tax must be definitely stated; it must be either a defined expenditure, a defined class of expenditures, or a defined fund for future expenditures. The law, by making the tax for "the ordinary and current expenses of the state," did not provide for a definite object, and it was claimed that it was there-

¹² Annual Report of New York State Assessors, Senate Documents, 1882, Vol. 5, No. 58.

¹³ Annual Report of New York State Comptroller, Assembly Documents, 1882, Vol. 1, No. 3.

¹⁴ Annual Report of New York State Comptroller, Assembly Documents, 1882, Vol. 1, No. 3.

¹⁵ 92 N. Y., 328.

fore unconstitutional. The second ground for objection was that the tax impeded and burdened the action of the United States government and was for this reason invalid. Less important objections were that a general tax on property of which United States bonds were a part was in effect a tax on the bonds and therefore invalid, and that the constitutional requirements of equality of burden was violated.

The Court of Appeals upheld the law at every point. As to the alleged abuse of a specified purpose, the court said that "the system by which finances of the state are classified and the purposes to which their money may be applied are embodied in numerous acts of the legislature creating various and distinct separate funds. Among these is a so-called general fund recognized by the constitution." Each of these funds, aside from the general fund, had some special object, and payments could not be made from it for any other purpose. Most of the current expenses were paid from this general fund and it was provided by the constitution that any appropriations made by the legislature not specifically charged to designated funds were to be paid out of it. A specification, therefore, the court held, for the replenishment of this fund was a sufficiently definite statement of the object of the tax. To have held otherwise would have been in conflict with precedent, for a law passed in 1855 levying a tax for the general fund was held to have a sufficiently definite purpose to meet the constitutional requirements.¹⁶

The question whether it was constitutional to tax capital stock invested in United States bonds was also answered affirmatively. The point upon which the decision hinged was whether the assessment was upon the franchise, or whether it was upon the property of the corporation. The court held that the assessment was upon the franchise and cited precedent where it had been held lawful for legislative power to prescribe a rule of value.¹⁷ It could not be denied that a fair measure of the value of franchises of corporations would be the prof-

¹⁶ *People ex rel. Burrows vs Supervisors*, 17 N. Y., 235.

¹⁷ *Monroe Savings Bank vs City of New York*, 37 N. Y., 365.

its resulting from their use, and it could not be maintained that such a rule was unequal in its effect upon different corporations or unjust in general operations. The tax was to be a franchise tax and not a property tax; it was levied upon corporations alone, and one of the penalties for non-payment was forfeiture of character. The tax was levied upon business prosperity as evidenced by the power to declare dividends and not upon the value of the corporate property. Income was used merely as a measure of ability to pay.

This case was finally carried to the United States Supreme Court which held, as did the state court, that the authorities were not required to deduct the amount of stock which the company held in United States bonds and compute taxes only upon dividends derived from the remainder.¹⁸ Double taxation was not upheld as a valid complaint against the law. It was decided that the legislature may, at its discretion, impose unequal or double taxes, and in determining a question of legislative power the courts were precluded from interfering.¹⁹

Most of the cases which arose were in regard to the application of the law in particular cases rather than attacks upon its constitutionality. So far as broad questions of principle were concerned, subsequent decision followed the findings in the Home Insurance Company case. Some particular assessments made under the law, however, were declared illegal. The case of the Albany and Greenbush Bridge Company is interesting because of the suggestion made for determining the value of real estate for taxation purposes. The board of assessors had made the assess-

¹⁸ *People vs Home Insurance Company*, 199 U. S., 129.

¹⁹ Some corporations, after paying the state tax sought to be freed from local taxes. In the cases of *Westchester Fire Insurance Company vs Davenport* (25 Hun, 630) and *Eastern Transportation Line vs Commissioner of Taxes* (26 Hun, 446) the court held that the taxes under the law were for the exclusive benefit of the state, and the act did not interfere with the power of local authorities to impose further taxes for municipal or county purposes. In the case of *Western Fire Insurance Company vs Davenport* (91 N. Y., 574) the courts hold that the exemptions granted under the law were only exemptions for the state taxes and did not affect the right to tax for local purposes.

ment at \$280,000.00 and the company made application to have it reduced to \$110,000.00. The assessors refused to comply and the case was carried to the Supreme Court which decided the reduction should be made. In determining the value of real estate for taxation, it held, the cost of acquiring such property may be considered, yet a more controlling consideration is the earning capacity.²⁰

Even though the new tax law was upheld in its entirety by the courts²¹ and the assessments made under it generally sustained, yet the system was not deemed perfect. It is obvious that injustice resulted as long as the entire capital of a foreign corporation doing business in the state was subject to the tax. An act was passed, however, in 1885 stipulating that the basis of taxation of foreign corporations under the law was to be the amount of capital stock employed within the state.²² Information on this point was required in the report made by foreign corporations, and the Comptroller was given power to investigate and modify the stated amount. Few corporations made protracted objections to the law yet criticisms arose because of the exemptions, evasions and large amount of litigation. In 1885 the Comptroller, aided by the Attorney General, submitted a bill to the legislature the passage of which he thought would minimize the difficulties.²³

One of the objections to the existing tax system was that the burden was unequally distributed between real estate and personal property. In a lengthy special report to the legislature in 1866 the Comptroller condemned the unjust burden upon real estate.²⁴ He dwelt particularly

²⁰ *Albany and Greenbush Bridge Company vs Assessors*, 34 Hun, 321.

²¹ In a letter to the Comptroller, December 18, 1883 (Annual Report to State Comptroller, 1883, p. 110) the Attorney General said that, in all of its essential features, the corporation law had been sustained by the highest court in the state in a manner very satisfactory to the officers who had its execution immediately in charge—the Comptroller and Attorney General.

²² New York Statutes, 1885 Chap. 501.

²³ Senate Documents, 1885, Vol. 6, No. 49.

²⁴ Special Report New York State Comptroller, Assembly Documents, 1886, Vol. 8, No. 89.

upon the rate of taxation, and attributed the inequality to fallacious assumptions under which corporations were taxed. The assumption was, he claimed, that corporate property was purchased solely by issues of stock and conversely that capital stock represented the entire value of corporate possessions. He continued to show that the capital stock represented by bonded indebtedness practically escaped taxation. This idea, however, does not conform to his justification for deducting the value of real estate from the value of capital stock in computing the annual franchise tax. This should be done to avoid double taxation since a part of the capital stock was invested in real estate. His idea, it seems, was that the tax attempted to reach the otherwise untaxed personal equities in the corporation. Real estate was taxed directly and the bond holders were (in theory) taxed on their bonds. Only shares of stock were not taxed directly. Had bond issues been considered as capital stock, as suggested, the property would have been doubly taxed. A system of taxing corporations on bonds based upon the amount of interest paid was suggested and, according to the Comptroller's interpretation of the law, very properly rejected.

We find the question of taxing indebtedness frequently discussed in governors' messages and state officials' reports. A special tax on bonds collected by the Comptroller; a tax on the sales of securities; the assessments of corporations on the basis of net or gross earnings; the adoption of some uniform rule of valuation to be used by local assessors regardless of ownership; these schemes all had their advocates. The Comptroller, in his report for 1887, advocated a more effective tax upon indebtedness, and presented the draft of a bill to tax such securities one-fourth of a mill for every one per cent interest paid.²⁵

All these protests and recommendations accomplished

²⁵ Annual Report of New York State Comptroller, Assembly Documents, 1887, Vol. 1, No. 3. This proposal was quite similar to present proposals for a millage tax. New York is now attempting to handle the taxing of some securities through the secured debts law (New York Statutes, 1911, Chap. 802).

no results at the time. The only legislation of importance was a new organization tax adopted in 1886.²⁶ Thereafter every corporation, joint stock company, or association incorporated by or under any general or special law of the state, having capital stock divided into shares, was to pay for state purposes a tax of one-eighth of one per cent upon the amount of its authorized capital stock. A like tax was to be paid upon future increases in capitalization, and no corporate powers could be granted or exercised until the tax was paid. Corporations not for profit were exempt from the tax.

The law was welcomed as a proper compensation for the valuable privilege of exercising corporate powers. The *New York Times* Said: "The bill imposing a tax of one-eighth of one per cent upon capital stock of corporations hereafter formed, as compensation to the state for the privilege of incorporation, provides for but a moderate charge for the granting of corporate franchises. Aggregated capital enjoys many advantages under our laws and the direct return it makes is inadequate. The tax would be no check upon legitimate enterprise and would bear a small proportion to the advantage derived from the privilege of aggregating capital by incorporation for profitable purposes."²⁷

It was feared by some that the tax would check the organization of corporations in the state which might offset any advantages to be gained. The Comptroller, in his report for 1886, did not find such fears justified. He reported that, from the passage of the law on April 16 to September 30, \$53,600.06 had been collected, and that there had been no tendency to drive organizations from the state. He considered the law wise and just, and added if there were such enterprises that could not afford to bear the burden, the state could well afford to lose them.²⁸ As interpreted by the court an organization tax must be paid in case of the consolidation of two corpora-

²⁶ New York Statutes, 1886, Chap. 143.

²⁷ *New York Times*, Editorial, March 10, 1886.

²⁸ Annual Report of New York State Comptroller, Assembly Documents, 1887, Vol. 1, No. 3.

tions even though each had already paid such a tax.²⁹ Likewise a new corporaion formed under the reorganization act must pay the organization tax.³⁰ In 1901 the organization tax was reduced to one-twentieth of one per cent, to be in no case, however, less than one dollar.³¹ By the law of 1906³² if a company decreased capital and subsequently increased it, the tax must be paid only upon the excess of new capital over what bore the first tax. In consolidation any excess of capital over the combined capital previously taxed must bear the organization tax. Another statute enacted in 1889 gave the Comptroller power to adjust the claims of any company for taxes illegally paid, and provided that such adjustment might be reviewed by the Supreme Court.³³ This was necessary because of a number of court decisions which had declared that some taxes had been illegally assessed.

The slight modifications just noted did not satisfy those interested in thoroughgoing tax reform. The receipts from corporation taxes were falling off. This was due partly to court decisions narrowing the scope of the law, and partly because in preceding years items for enormous taxes were allowed to be credited to future taxes. The extension of exceptions; rebates because of illegal assessments; the statute providing that only the portion of the capital employed in the state was subject to tax; and the rebates and decline in revenue occasioned by the decision of the Supreme Court making it illegal to tax interstate commerce were factors in causing the revenue to fall off,³⁴ while it was believed that corporations were leaving the state.³⁵

²⁹ *New York Phonograph Company vs Rice*, 57 Hun, 486.

³⁰ *People vs Cork*, 110 N. Y., 443. This was changed by law in 1806. See text.

³¹ New York Statutes, 1901, Chap. 448. This was changed to five dollars in 1910 (Chap. 472.)

³² New York Statutes, 1906, Chap. 524.

³³ New York Statutes, 1889, Chap. 463.

³⁴ See Annual Report New York State Comptroller, 1889, p. 28. For the last previous fiscal year the organization tax had fallen off almost \$20,000.

³⁵ In testimony before the special commission in 1893, (Assembly Documents, 1893, Vol. 13, No. 69) Mr. T. L. Feitner, a commission-

The annual franchise tax was often partially evaded because dividends were made the basis for computing the tax. It was reported that many companies were earning profits of from five to fifty per cent, sometimes more, upon their capital, but distributed only a part in dividends, turning the rest into surplus. In such cases the state received nothing from the amount of earnings passed to the surplus fund. It would have been more equitable, of course, to have based the tax on the amount earned, whether distributed or not, rather than upon dividends declared. Comptrollers generally wished to relieve real estate from the burden of state taxation, and pointed to the disproportionate burden thrown upon this class of property by the evasion which corporations were practicing.

The courts, meanwhile, were frequently called upon to interpret the law of 1880, as amended. The term "incorporated or organized under any law of this state" was to include any combination of individuals which claimed privileges not enjoyed by individuals or copartnerships.³⁶ The term "doing business in this state" had reference only to foreign corporations. The tax was not upon property, but upon franchise; and domestic corporations were not exempt from taxation upon the amount of business done outside the state.³⁷ There was no limit to the time in which a corporation might apply to the Comptroller for revision of a tax levied against it, nor could the Comptroller refund any taxes illegally collected. Such refunds could only be made through legislative appropriation.³⁸

er of taxes in New York City, expressed the opinion that it was not alone the special taxes upon corporations which led them to incorporate in other states. He thought the reports required caused more publicity than they desired. He considered the system a good one because it caused the home companies to be looked upon as creditable while those going out of the state were considered more or less fraudulent.

³⁶ *People vs Wemple*, 117 N. Y., 136.

³⁷ *American Contracting and Dredging Company vs Wemple*, 129 N. Y., 558.

³⁸ *In re Duffy*, 133 N. Y., 152.

This difficulty was soon eliminated by legislative enactment.³⁹

The tax law of 1881 was materially amended in 1896⁴⁰ and again in 1906.⁴¹ The fundamental principle of an annual franchise tax on capital stock was retained, but attempts were made to formulate more distinct classifications. The law of 1881, as here amended, gives the system by which the annual franchise tax is assessed upon the capital stock of corporations.

Corporations subject to the annual franchise tax are required to make yearly reports to the comptroller stating the amount of authorized capital stock, the amount of stock paid in, the date and rate of each dividend declared, the entire amount of capital and the amount of capital employed in the state. The tax is to be paid in advance, and is based upon the amount of capital stock employed within the state during the preceding year. The capital stock employed in the state is the same proportion of the entire capital stock as assets within the state bear to the entire assets.

The classification of capital stock for the purpose of assessing the annual franchise tax is as follows: (1) If dividends have amounted to six or more per cent upon the par value of the stock, the tax rate is one-fourth of a mill for each per cent of dividends made or declared. (2) If dividends have been less than six per cent and (a) assets do not exceed liabilities, exclusive of capital stock, or (b) the average selling price of the stock during the year has been below par, or (c) if no dividend was declared, then the rate of tax is three fourths of a mill. (3) If dividends have been less than six per cent and (a) assets exceed liabilities, exclusive of capital stock, by an amount equal to or greater than the par value of the stock or (b) if the average selling price of the stock has been above par, the tax rate is one and one-half mills, but the valuation of the stock shall not be less than (a) par value; (b) difference

³⁹ New York Statutes, 1889, Chap. 463 gives the Comptroller power to make refunds.

⁴⁰ New York Statutes, 1896, Chap. 908.

⁴¹ New York Statutes, 1906, Chap. 474.

between assets and liabilities, exclusive of capital stock; (c) average selling price of the stock during the year. (4) If a part of the capital stock has paid more than six per cent dividend while a part has paid no dividend or less, the above rules are to be applied to each portion of the stock as if it existed alone. (5) Corporations not assessable by the above rules are to be taxed by an amount not less than would be produced by an assessment of (a) one and one-half mills on the actual value of the capital stock, or (b) one and one-half mills on the average selling price during the year.

A number of corporations, however, are exempt from the annual franchise tax on capital stock. These are banks, savings banks, insurance companies, trust companies, manufacturing and laundering companies, (to the extent of capital actually employed in the state in manufacturing and selling products of such manufacturing,) mining companies wholly engaged in mining within the state, agricultural and horticultural associations. Companies owning or operating elevated railroads or surface roads not operated by steam, and companies formed for supplying water or gas, for electric or steam heating, lighting or power purposes are also exempt from the tax. To secure exemption, laundering, manufacturing, and mining companies must have at least forty per cent of their capital stock invested in property within the state, and used for laundering, manufacturing, or mining purposes.⁴²

From the tone of these provisions we may infer that there has been a change in the general attitude towards corporations. While once they had been favored and encouraged by special exemptions, and lax administrative laws, they were now viewed as the owners of special privileges, properly liable to taxation. Some small tendency appears, too, to depart from the principle of the general property tax, although it remains in large measure the basis of the system. In general, it is clear that, in these

⁴² The provisions for taxing corporations exempt from the annual franchise tax on capital stock are discussed in the chapters dealing with such corporations.

laws, corporations were to be dealt with more stringently than individuals.

The law, as given above, left many points for judicial interpretation. The question as to what "capital stock" means, and how it shall be used in applying the law has often arisen. The answers of the courts have not always been consistent. The Court of Appeals defined it as meaning not the share stock held by individuals, but the actual capital which this represented.⁴³ As the basis for the franchise tax it was the equivalent of the term "capital", and was the amount of capital so employed upon which the tax was to be computed. It further held that bonds, whether United States bonds or not, in the absence of proof that they were bought with a corporation's surplus, should be treated as capital employed in the state, and as a part of the basis upon which the franchise tax should be computed. Holdings in other corporations were to be treated in like manner.

Where no dividends were paid or where they were less than six per cent, the actual and not the par value of the capital stock employed within the state was held to be the proper basis for computing the franchise tax. Where there had been no dividends or sales of stock, the value was to be determined by taking the value of the assets after deducting liabilities and adding to the sum then remaining the value of the good will of the business, including its right to conduct business under a franchise.⁴⁴ The tax was to be based upon capital activity employed in its corporate business, and not upon the passive holding of it in unproductive land. A corporation whose entire capital stock was issued in payment for an island consisting of unimproved swamp land was not taxable on its capital stock.⁴⁵ In case no dividend has been declared,

⁴³ *Commercial Cable Company vs Morgan*, 178 N. Y., 433.

⁴⁴ *People vs Roberts*, 154 N. Y., 101.

⁴⁵ *Niagara River Hydraulic Company vs Roberts*, 30 Supreme Court, Appellate Division, 180. The Court of Appeals later held (198 N. Y., 250) that the law did not mean that capital stock should be employed in business to render it taxable. If the stock was represented by real estate it must be deemed to have been "employed" within the meaning of that expression of the law.

the Comptroller may estimate the value of the capital stock at the average price for which the stock has sold during the year although such price may exceed the par value of the stock and thus indirectly tax the surplus.⁴⁶ The average amount of capital employed during the year, and not the amount in use at any one time must be taken as the basis for the tax.⁴⁷

The state had the power to impose a franchise tax, even if substantially all the property appraised was exempt by United States statute.⁴⁸ The imposition of the franchise tax computed upon dividends was not a tax upon property, and did not violate the restriction of the federal constitution prohibiting states from interfering with imports from other states or foreign countries.⁴⁹ The part of the capital stock of a New York corporation represented by merchandise temporarily in the hands of selling agents outside the state, which is not sold but is brought back into the state, is taxable.⁵⁰

The increase of exemptions from the annual franchise tax led to the testing of the constitutionality of the law in respect to the principle of uniformity. The Court of Appeals held that by merely exacting a payment for the privilege of exercising corporate powers, the state did not impose a property tax. The legislature, it held, is not bound to impose the same conditions upon all corporations for the privilege of doing business in New York.

It may grant or withhold the privilege in the case of each corporation as it sees fit, and the rules relating to the taxation of property do not apply.⁵¹

These laws constitute the method for assessing the annual franchise tax. The basis for the tax is capital stock while the rate is determined by a number of variable factors—dividends, market price of stock, and financial con-

⁴⁶ *Colonial Trust Company vs Morgan*, 162 N. Y., 654.

⁴⁷ *Brooklyn Rapid Transit Company vs Morgan*, 57 Supreme Court, Appellate Division, 335.

⁴⁸ *U. S. A. P. P. Company vs Knight*, 174 N. Y., 475.

⁴⁹ *Matheson vs Roberts*, 158 N. Y., 162.

⁵⁰ *Farmers' Loan and Trust Company vs Wells*, 180 N. Y., 16

⁵¹ *Vanderwort Company vs Glynn*, 194 N. Y., 387.

dition of the corporation. The payment of this tax relieves the capital stock from any other tax for state purposes. It is, however, assessed locally for local purposes. It seems an attempt has been made to consider the profitableness of a company in determining the tax since classifications are based upon dividends. Some of the difficulties which have arisen under the law of 1880, as amended, we shall consider the next chapter.

CHAPTER III.

PROBLEMS AND DIFFICULTIES OF GENERAL TAX ON CORPORATIONS

Since 1880 corporations, except those exempt by law, have borne the annual franchise tax upon their capital stock. This method is an improvement over the one previously used and has not been void of good results. The direct system of raising taxes for state purposes has been superseded, to a great extent, by the indirect system. In earlier years the direct tax was easily levied, was simple, and largely satisfactory in operation. The few towns and small amount of personal property went hand in hand with a government of trivial expenses. As industrial organization became more complex the tax laws failed to properly classify property and property owners, and injustice resulted. Personal property evaded assessment while real property bore a disproportionate burden of the tax. The amount of personal property increased rapidly yet the amount found on the assessment rolls actually decreased from year to year. Not only was little personality reached, but the valuation of realty in the different districts was so haphazard, either by accident or design, that it became necessary to establish equalizing tribunals. Equalizing, under the circumstances, could not be adequate and much injustice remained.

The annual franchise tax attempts to remedy the evils which had grown up. Personal property, undoubtedly, is made to bear more of its legitimate burden while the lack of uniformity through local assessments has been eliminated. The evasion which arose under the requirement that personal property be assessed at the place of the principal office has likewise been stopped.

From the standpoint of revenue and expense of collec-

tion the tax is in a large measure satisfactory. While not as much is received from this source as in some other states, it forms an important part of the income of the state.¹ From 1900 to 1902 there was an increase of 200 per cent in the number of corporations taxed which of course greatly increased the revenue.² The expense of collection and administration has been less than one per cent., and the number of corporations paying the tax in 1903 was more than 7500. There are now more than 40,000 corporations paying the tax.

Many difficulties and problems, however, still present themselves. One which has always existed and which still proves troublesome is in the determination of the value of capital stock. The Attorney General, in his report for 1898,³ quotes the language of the court in the *Union Trust Company vs Coleman*, (126 N. Y., 443), that "capital stock is not the share stock but the company's capital and surplus which should be assessed at its actual value when that is known or can be ascertained." A distinction was drawn between the capital stock of a company and that of the shareholder. That of a company, it held, is simply its property existing in money or property or both, while that of the shareholder is representative, not merely of the existing and tangible capital, but also of surplus, dividend earning power, franchise, and goodwill of an established business. The capital stock of a company is owned and held by the company in its corporate character; that of the shareholders is owned and held by them in different proportions as individuals. The one belongs to the corporation, the other to the corporators. The actual value of the capital may be widely different from the share value although the par value always corresponds to it. The law intended to deal with the com-

¹ The income from this source is between three and four million dollars. It is almost one-third of the amount received from all forms of corporation taxes.

² This increase can largely be attributed to the legislation in 1901, affecting the status of foreign corporations.

³ Report of the Attorney General, 1898, Senate Documents, Vol. 1, No. 9.

pany's capital, not with the share stock which it does not own.

If this opinion were to be strictly followed the share stock would have nothing to do with the subject of valuation. Only the capital and surplus of the corporation, assessed at its own value without regard to the selling value of its shares, could be considered. The distinction which the court draws is, of course, sound, but the value of the one thing is often reflected in the value of the other. If a company has a large amount of surplus from which dividends are being paid, the share stock will be more valuable. On the other hand, the value of a company's capital is not always shown by the share value. If a company put its earnings into betterment it may cause a small dividend which in turn will be reflected in a low selling value of the share. Where the value of the capital stock is difficult to ascertain the value of the share might well be considered as one of the determining factors.

The courts have not consistently held to this opinion but have deviated so frequently that it would be impossible to follow their rulings in assessing the capital stock. They have proposed one method where the dividend declared is above six per cent, another where it is below, and still a third for foreign corporations. There can be no good reason for different methods of valuation in these cases. Should it be considered desirable, as the court procedure would indicate, that different classes of corporations should not be taxed uniformly, the result should be secured through the rate of tax and not through different methods of valuation.

The legislative exemption of secured bonds⁴ from taxation gives corporations a chance to evade all or part of the annual franchise tax. Often stock is issued as a bonus and the only real value received into the treasury is from the sale of bonds. Such corporations exercise exactly the

⁴The secured debts tax law was passed in 1911 (Chap. 802). By its provision any bond secured by mortgage on real property, by a deed of trust or real or personal property, or by the deposit of securities as collateral is exempt from payment of taxes after a tax of one-half of one per cent has been paid and stamps have been affixed indicating the payment.

same franchise privileges as if their stock had been issued for actual property. When the bonded indebtedness is considered a liability and deducted from assets in determining the amount of capital stock, often there is little left upon which to levy a tax. The franchise of such companies are just as valuable as if all the assets were represented by shares of stock, yet the existence of bonds makes the capital stock of little value for tax purposes. Not only do bonds contribute to the evasion of the tax, but the very fact that they are issued influences the classification of a corporation for the purpose of taxation. Bond issues keep down dividend rates, which, according to the law, are the basis upon which classification is to be made. In cases where the tax is based upon the average market value of the stock a heavy bond issue might materially reduce the assessment.

It is generally believed that the corporate form gives advantages for which the corporation should pay. If the capital stock, through the annual franchise tax, be taken as the basis for this payment, the system should be clarified and simplified. The confusion arising from court decisions between capital stock and capital as basis for the tax should be cleared up. *Capital stock* is generally taken to mean the share value, the actual value of which, depending upon a variety of causes, may change from day to day. This in itself would be an inefficient basis, but might well be used as a factor in determining the value of *capital*. By *capital* we generally mean the definite tangible or intangible assets with which a corporation may do business. Under this would come personal and real property, such as cash, accounts receivable, merchandise, and all items such as trade marks, good will, etc., which enable a company to carry out those purposes for which it was formed. Since such items are not always accurately reflected in the share value the capital would form a much better basis for the tax. The rules for classification, however, should be simplified and the duties of the comptroller lightened. The application of the present system to some forty thousand corporations involves an enormous

amount of clerical work, and renders it difficult to detect inaccuracies.

The complexity of the law is a disadvantage. In 1893 the legislative committee investigated the matter of taxation. This inquiry showed that the complexity of the law—and subsequent amendments have made it still more complex—had caused many corporations to leave the state. The witnesses before the committee contended for the simplification of the laws so that corporations could know what to pay and what might be collected. The law has not been constructed on a scientific basis but has been made piece meal by different legislatures. Mr. George F. Seward said: "It is hardly conceivable, yet true, that one cannot find by study of the statutes, any indication that the work of any of these commissions which have been apointed during the last forty years, or all of them together, have made any impression upon the legislature."⁵ The use of these complex measures for taxing corporations instead of adopting some carefully worked out system has resulted in seriously burdening some while others have practically escaped taxation.

Governor Dix in his message of July 12, 1911⁶ vigorously attacked the complexity of the law:

Section 182, under which corporations are taxed for the privilege of doing business in a corporate capacity, has been a constant source of litigation. It is so complicated that no ordinary business man can understand its provisions and even the Court of Appeals has complained that the legislature seems to have tried to express a very simple idea in very complicated language. Yet over forty thousand business corporations are assessed annually under this statute and are compelled to make reports in regard to which their officers are in hopeless confusion and even their attorneys are frequently bewildered in their efforts to comply with its provisions.

The law is difficult to interpret and as a result of its vagueness and complexity millions of dollars are levied with no certain rule. The assessment, moreover, is left to one official with no possibility of proper check or supervision. The public can generally neither know the basis of taxation nor whether the amounts collected are proper or not.

⁵ National Conference on Taxation, Buffalo, 1901. p. 116.

⁶ Public Papers of Governor Dix, 1911, p. 73.

The complexity of the situation has discouraged rather than encouraged the collection of the tax. Courts have been busy determining which provisions of the law applied to different companies. In one case at least they removed from the list one whole class of property that had hitherto paid the tax.⁷ The decision held that a company organized for the purpose of purchasing and holding real estate was not employing its capital in doing business in the state. In this particular case the amount invested was \$150,000. Soon after the investment the property was sold for \$750,000 which would indicate that the company had employed its capital in a fairly satisfactory business transaction. In one year the decision caused 541 corporations to be removed from the tax roll. This is but an example of situations arising because of lack of clearness. Here capital was "invested" and not "employed"—hence the law did not apply. The Comptroller suggested that if capital could be "invested" without being "employed" it was time to so word the statute that capital employed, invested or held in the state would come under the law. While this class of capital escaped entirely others have been unduly burdened, and it was generally believed that large sums of New York capital sought incorporation in other states. Governor Odell, in his message of 1901⁸ pointed out that corporations were treated more liberally in other states than in New York. This forced the capital to other states and New York lost the revenue which they enjoyed at her expense. He pointed out that during the previous year only \$340,000,000 was organized under New York laws while single corporations with a greater capitalization than this had been organized in other states.

This chaotic and complicated tax law can be accounted for because of the way by which it came into existence. The demands for revenue increased more than eight times as fast as the population. As these new demands for revenue arose a new tax was imposed to meet

⁷ Annual Report of New York State Comptroller, 1900, p. *xix*.

⁸ Governor Odell's Message, 1901. Assembly Documents, 1901, Vol. 1. No. 2.

the need and finally became imbedded as a part of the regular system. That legislators allow such a system to continue is not because they have never had their attention called to conditions. Practically every official and organization connected with tax administration or interested in tax reform has pointed out the difficulties and asked for remedies. The State Comptroller in his report for 1899 said: "It is unfortunate, both as regards the tax payer and the subject of taxation that many cases arise where the determination of the courts must be had, and where often times the tax assessed and collected is inequitable and, aside from the letter of the statute law, has no justification."⁹ The opinions expressed in practically every other Comptroller's report have been similar, always decrying the complications and asking for simplicity and justice. The newspapers have repeatedly laid bare difficulties and criticized those responsible for not giving relief. A number of special tax commissions have been appointed to investigate the system which generally reported the cumbrousness of the law. The Commissioners of Taxes and Assessments for New York city have been active in advocating reform while the New York Tax Reform Association has repeatedly drawn up laws and amendments, and attempted in almost every conceivable way to get some change.

A number of loop holes exist through which evasions are possible, and which cause more inequality and injustice than should exist. Since the courts have held that the taxes are a payment for past benefits and not for future privileges, a number of corporations, especially foreign, moved out of the jurisdiction of the state just before being assessed. The amount of revenue lost by such practices is considerable. The use of the amount of capital "employed in doing business in this state" as a basis for the tax allows much capital to escape taxation. This is especially true of foreign corporations and will be discussed in Chapter IV.

Corporations which pay the annual franchise tax are

⁹ Annual Report New York State Comptroller, Assembly Documents, 1899, Vol. 1, No. 3.

exempt locally from all taxation upon personal property for state purposes. Since the real estate is not exempt, injustice is borne by the corporation with a comparatively large amount of real estate. The State Comptroller in his report for 1900,¹⁰ said that a company doing manufacturing business pretty generally took advantage of the provision. For example, he said, a company may employ one or two thousand dollars in handling goods of other makers and pay a tax of a few dollars. By doing this it secures exemption from local taxation on personal property for state purposes when it may have several thousand dollars which would otherwise be subject to such tax. This again discriminates unjustly against the holder of a large amount of real estate. Stock-watering has also been extensively practiced. This keeps the rate of dividend low, and puts the corporation in a class with lower taxation even though the return upon the actual investment may be high.

The methods employed for dealing with delinquent companies have not been entirely satisfactory. The procedure is for the Comptroller to issue a warrant to the county sheriff, ordering him to sell the property of the company in order to satisfy the tax claims. It is difficult, however, for the sheriff to sell such intangible property as good will, services, etc. Neither have sheriffs appeared to be over-zealous in attempting to find property upon which to levy a tax claim. When it is found, moreover, it is often so heavily encumbered that under a sheriff's sale there would be little equity left to the state to satisfy taxes and cost of collection. An attempt has been made to deal with delinquents through annulling their charters. If a tax account remains unpaid for a year and the Comptroller is satisfied that the delay is intentional, he notifies the Attorney-General to bring action to annul the charter.

The method of dealing with other forms of delinquency, such as failures to file a report, is also inadequate, expensive, and time consuming. Action must be by the Attorney-General at the instance of the Comptroller. In

¹⁰ Annual Report of the New York State Comptroller, 1900, p. xxi.

many cases enforcement is practically impossible. This system may have been fairly efficient when it was inaugurated for then there were only some two thousand corporations on the taxing list, but there are now more than forty thousand demanding the attention of the bureau. More than five per cent of these, moreover, are delinquent in some way every year. To expect the Attorney-General annually to commence proceedings in over eight hundred cases is unreasonable. Annulment of the charter by the Comptroller in cases of intentional delinquency would perhaps be an adequate remedy. This would have the incidental advantage of doing away with a number of corporations which exist only on paper.

The taxation system has been severely criticized because it does not place the same burden upon individuals as is placed upon corporations. By individuals is meant the large business organizations in the form of partnerships. The regulations applicable to corporations do not apply to individuals. Corporations are subject to special kinds of taxation which individuals escape. Many examples exist where corporations are burdened much more heavily than other companies doing practically the same kind of business. The manner of assessment is entirely different. Corporations must prepare technical and complicated reports which make the advice of an attorney necessary while the individual, taxed only locally, is assessed before the local assessor. Individuals may deduct all personal debts while no such deductions are allowed to corporations. Granting these discrepancies, we cannot conclude, however, that all business organizations should be taxed on the same basis. In so far as the corporate charter grants advantages and privileges there is no reason why they should not be compensated for in the form of taxes. If the price asked be too high there is nothing to compel new business enterprises to take on the corporate rather than the partnership form. A heavy tax on corporations, however, may prove to be an unjust burden to those already in existence. For many corporations it would be next to impossible to change to a partnership organization. Since corporations have proved particu-

larly efficient in the development of industry and therefore socially desirable, taxes should not be so oppressive as to discourage this form of organization.

These are some of the difficulties connected with taxing corporations for state purposes. The assessments of corporate property, both real estate and capital stock,¹¹ for local purposes likewise presents difficulties. Although statistics for local taxes are not available, there is no doubt that the aggregate is much larger than the taxes paid for state purposes. The assessments are made by local officials under practically the personal property tax system. Here the evils of the system are enhanced by the complexity and magnitude of the assessments. Real estate is assessed at its situs while the capital stock is assessed at the place of the principal office. Since corporations may choose the place for their principal office it is possible to shift this from one district to another to escape taxation. Instances have arisen, both among domestic and foreign corporations, where this has been done. Where the shifting is with a view to securing better terms of assessment it is sometimes done with the collusion of local tax officials. Assessors are sometimes lenient in order to get the corporation to declare its principal office in their district. Many New York city corporations, whose business is practically all located there, have declared their principal office to be located elsewhere. Such practices, of course, work injustice among districts and among corporations. The very possibility of its existence is enough to condemn it and demand reform.

The valuation of real estate by the different assessors affords a special problem in the case of corporations. Very often the assessor can only take the officers' word for the valuation since he himself is not competent to judge. Different districts are desirous of increasing their population and business by having industries locate

¹¹ Article 1, Section 11 of the tax law would indicate that all personal property was to be assessed and taxed locally. In the instructions for preparing the assessment roll, section 21, however, provision is made only for assessing the capital stock as provided for in section 12. This causes only capital stock to be assessed and is another illustration of the inconsistency of the tax law.

within their borders, and promises of low taxes are often given as an inducement. Injustice is found here as well as in the assessment of personal property and measures are needed to abolish the practices which exist.

The method prescribed by law for the assessment and taxation of the personal property of corporations for local purposes is so complex that few, if any local assessors are able to apply it. It is not the value of the share stock that is the basis of taxation, but rather the capital invested in the business. The formula which the assessors are expected to use is somewhat as follows: On one side of the assessment roll is to be placed the value of the total assets of the corporation including the entire value of real as well as personal property, non-taxable as well as taxable. From this is to be deducted the other side of the assessment roll on which is found the value of the stock owned by the state and incorporated charitable or literary societies; all property exempt by law, including shares of stock of other corporations; the assessed value of the real estate; debts and surplus, if any, up to the amount of ten per cent of the capital.

The sum secured by this process represents the assessable value of the capital stock. Corporations are required to make reports but the information thus obtained is so inadequate as to be of little use to the assessors. Since judges and lawyers have failed to reach an agreement as to the meaning of the law, the assessors cannot be expected to use it successfully. They generally assess individuals and corporations in the same manner. Since personality so largely escapes an unjust burden falls upon corporations with a large percentage of real estate.

Because of these difficulties many have advocated that the local assessment of personal property of corporations be abolished. The State Tax Commission in 1898 made such a recommendation.¹² It contended that the other corporate taxes involved the taxation of personality. It wanted to equalize and extend the other taxes so as to reach the source of personal investment, and at the same time relieve the assessors of the hopeless task of finding

¹² Annual Report of New York State Tax Commission, 1898, p. 11.

personal property. The special tax commission which reported in 1907¹³ thought it advisable to extend the system of taxing corporations for state purposes so as to include all corporation taxes. It would allow real estate to continue to be taxed locally, but all personal property taxes were to be taken care of through an increased franchise tax, a part of which was to be returned to the locality. Such a scheme was calculated to give greater equity and more revenue to both the state and the locality.

The State Comptrollers for a number of years have been asking for reform but without success. The State Conference on Taxation in 1911 unanimously adopted a resolution asking that the taxes be determined by some simple rule. Governor Dix in his message of 1911 dealt extensively with corporate taxation and asked for reform.¹⁴ He suggested that the annual franchise tax be computed upon the par value of the stock. This would insure simplicity in calculation which any tax-payer could understand, and would also eliminate the necessity for the frequent arbitrary judgment of taxing officials. He gave his sanction to a bill which had been introduced proposing a minimum tax of three-fourths of a mill on each dollar of issued capital stock. This was designated as a tax for the privilege of using a corporate name and exercising corporate power. Taxes were to vary with different classes of corporations depending upon the amount of dividends paid.

This scheme evidently would have been easy to understand and administer, and would doubtless have eliminated much of the litigation caused by the present procedure. It would act as a check upon taxing officials since in each case the amount of the tax paid could easily be compared with the basis upon which it was levied. A further advantage would arise in the tendency to reduce inflated capitalizations. As a license tax little objection can be made to the scheme.

¹³ Report of the Special Tax Commission, 1907, Senate Documents, 1907, Vol. 5, No. 11.

¹⁴ Message of Governor Dix. Public Papers of Governor Dix, 1911, p. 73.

The report of the Comptroller for 1911 dwelt on the ambiguity and uncertainty of construction in the law. Although his recommendations were adopted by the Senate, they failed to reach a vote in the House. At the extraordinary session of that year he made another unsuccessful attempt. He suggested that the annual franchise tax be upon the basis of capital stock. The tax, to be paid annually in advance, was to be computed upon the basis of the capital stock employed during the preceding year within the state. The amount of capital stock was to be such portion of the issued capital stock as the gross assets of the business in the state bore to the entire gross assets. The tax rate was to vary, according to dividends paid, from three-fourths of a mill where no dividends were paid to one-fourth of a mill for each one per cent of dividends above six per cent. The minimum tax was fixed at five dollars. The scheme would have eliminated many of the administrative difficulties yet some injustice would doubtless have remained.

The organization tax has been much discussed. It is generally connected with the phrase "driving capital from the state." If the organization tax be high it is believed capital will seek organization in the more favorable states. From the standpoint of revenue this could make little difference aside from the organization tax itself, if the foreign corporation tax laws are properly framed. The possibility exists, however, that, where advantages of location are negligible, and industry may seek the state of lower organization tax. The loss comes largely to the forms of business which would partially depend upon the industry if located within the state. While the organization tax does not have the effect commonly supposed it may be well to gauge it somewhat by similar taxes in other states.

The complete separation of the sources of state and local revenues has been advocated by some as a cure-all for tax evils. No doubt some sources of revenue are better suited for state taxation, and should be taken over by the state. The great body of local tax payers should not be freed, however, from all state responsibility. In

New York a small amount of the taxes collected locally are used for state purposes. Under complete separation the great majority of voters would have no interest in the state revenues other than how they would be spent. Who would bear the expense, would be of little concern and it is not hard to imagine that unwise and burdensome appropriations might be made. However desirable the separation of state and local revenues may be from the administrative standpoint, the social defects overshadow the advantages. In order that the majority of the citizens retain their interest in state affairs and may not be tempted to squander revenues they do not help to pay, it is desirable that a part of the locally collected taxes be used for state purposes.

It seems the personal property tax is strongly entrenched. Many tax authorities would willingly adopt the income basis. The past lethargy of the legislature, however, would indicate that we need not expect such a step in the near future. The first reform we can hope to secure is to make the old system more workable as well as more just. In the past recommendations of officials and commissions have met with little success. The recent success of reforms, however, in other phases of taxation, leads us to hope that the legislature will yet attempt to simplify corporate taxation. The sooner this can be accomplished, through the adoption of some suggestion already made or otherwise, the sooner will the courts be relieved of part of their burdens, the sooner will corporate officials be able to calculate the amount of taxes they may be expected to pay, and the sooner will state officials be relieved from much of the unnecessary administrative burden now borne by them.

THE STOCK TRANSFER TAX¹⁵

Before leaving the discussion of the general taxation for tax. In 1881 a bill was introduced proposing to levy a tax of one-fifth of a mill on every dollars of brokers' sales. Of corporations we shall briefly consider the stock trans-

¹⁵ In reality this is not a tax upon corporations but upon the exchange or sale of shares of stock. It does, however, affect them indirectly.

In 1887 a bill was introduced to tax the sales of stocks and bonds. Neither bill became a law, and it was not until several years later that the subject came up again. In 1905 the stock transfer tax law was added to the general tax law.¹⁶ By this act a tax of two cents on every \$100, face value, was placed upon the sale or exchange of shares and certificates of stock of all foreign and domestic corporations after June 1, 1905. Depositing stock as collateral security is not taxable. The payment of the tax is denoted by affixing adhesive stamps, either to books of company making sale (if sale be recorded) or to the memorandum or certificate of transfer where such is given. Heavy penalties are provided for failure to affix stamps, using canceled stamps, etc., while shares of stock transferred without the payment of the tax cannot be made the basis of legal proceedings.

As might be expected the constitutionality of the law was attacked from every possible angle. The greatest contention was that it is class legislation, hence contrary to state and federal constitutions. Both the Court of Appeals¹⁷ and the United States Supreme Court held that the tax was not upon property but upon the transfer of property. Since it was uniform in operation upon all transfers and upon all persons making them, it contravened neither the state nor federal constitution. The complaint upon interstate commerce was likewise rejected.

In 1907¹⁸ the law was amended so as to make the basis for the tax "each share of \$100 of face value or fraction thereof," instead of "each \$100 of face value or fraction thereof." The amendment made the share, whatever its value, the basis for the tax. By its provisions the tax on 100 ten dollar shares would be two dollars while the tax on ten one hundred dollar shares would be twenty cents. In these two cases the share value was the same yet the tax differed by one dollar and eighty cents. The Court of Appeals refused to sanction such discrepancies on the ground of class legislation since all corporate share hold-

¹⁶ New York Statutes, 1905, Chap. 241.

¹⁷ *Hatch vs Reardon*, 184 N. Y., 431. Affirmed 204 U. S., 157.

¹⁸ New York Statutes, 1907, Chap. 414.

ers were not treated alike. The legislature had exceeded their power of classification since such must have some other basis than mere accident, whim or caprice.¹⁹ The provision of the law which authorized the comptroller to secure evidence of violation from the private books of the company was likewise declared unconstitutional.²⁰ Certificates of shares turned over to a trust company under the voting trust arrangement, however, were held liable to the tax.²¹

The Comptroller has experienced difficulties in examining the records of offices to ascertain whether the law has been complied with. At first the state was defrauded of thousands of dollars because of the wholesale washing and reusing of stamps. Detectives were put to work, however, the offenders arrested, and the practice in a measure checked. Evasions, it would seem, are still possible since the amount of sales reported on the exchanges is much larger than the sale of stamps would indicate. The system of "balancing" and "paying on differences" which is used among brokers will partially explain the difference.

Because of evasions, the Comptroller, in his report for 1908, estimated that the state was losing \$2,000,000 a year. He suggested as a corrective measure that every person selling shares be required to make a monthly statement showing the amount of sales, together with the denomination and number of stamps used in paying the tax. The system recommended was practically the same as is used in the United States revenue. The desired modifications were not secured. In 1910 a bill making it unlawful for any but authorized agents to sell stamps, and then only at face value, passed the Senate. In the House the opposition which developed in the interests of the stamp dealers caused the defeat of the bill. A second attempt was made at the extraordinary session but with similar results. It was not long, however, until a law²²

¹⁹ *Farrington vs Mensching*, 187 N. Y., 8.

²⁰ *Ferguson vs Reardon*, 197 N. Y., 236.

²¹ *U. S. Radiator Company vs New York*, 208 N. Y., 144.

²² New York Statutes, 1911, Chap. 12.

was passed permitting only authorized agents and banks to sell stamps. This has been effective in cutting down losses from fraudulent transactions. It has also been made the duty of the person making the sale to procure and affix the stamps. Corporations must keep such records as the Comptroller may require, showing date of transfer, numbers of certificate issued and names of purchaser. Such records must be kept for two years.

The tax met with opposition, not alone from those directly affected but from other sources. Just after its constitutionality had been affirmed, it was attacked on the ground that it established a dangerous precedent for the taxation of energy and industry.²³ New York city business men felt that it was a discrimination against the city. The law had the effect of checking the increase of transactions on the stock exchange. Transactions increased much more rapidly on the Boston and Philadelphia exchanges than on the New York exchange.²⁴ If the law can be shown to greatly check stock exchange transactions its advisability can be questioned. The stock exchange is not all a gambling den and productive of no good as is generally believed. It exercises an important function in establishing a comparatively stable market for securities which greatly aids the progress of industry.

It has been advocated that the tax be increased from two to five cents. There is just as much reason for choosing the one as the other, it is claimed, while the latter would greatly enhance the revenue. The revenue now secured is quite large and it would be well to leave any possible increase till an emergency arises when it can be used to provide the flexible feature which a good tax system should possess. It would be better, in some ways, if the tax were based upon the market rather than the par value of the stock. There is no very good reason for taxing a one hundred dollar share selling for three hundred dollars as much as one selling for twenty-five dollars. A market value basis, however, would increase

²³ The *Outlook*, May 5, 1906. Vol. 83, p. 5.

²⁴ Pennsylvania adopted the stock transfer tax in 1915 while Massachusetts adopted it the previous year.

the administrative difficulties of the tax. In general it is a fair tax, easily assessed and productive of considerable revenue.

CHAPTER IV

THE TAXATION OF FOREIGN CORPORATIONS

The treatment of foreign corporations in New York State has varied widely. The legislature has dealt with such corporations, either by enacting statutes which affected the class as a whole or by laws designed for a particular kind, as insurance companies or banks. We find that the first legislation was most drastic. Until the year 1814 the insurance business was left entirely open to all who chose to undertake it. In that year the Phoenix Fire Insurance Company of London established an agency in New York. Since at this time England and the United States were at war and contracts with alien enemies could not be enforced, a bill, entitled, "An Act to Suppress Foreign Influence in this State," was introduced into the legislature. After an amendment had been added, which explained the object of the bill, it became a law.¹ All foreign insurance companies or their agencies were excluded from carrying on business in the state under a penalty of one thousand dollars for violation. This occurred at a time of exasperated feelings toward England but it had a marked influence upon later legislation concerning alien insurance companies. This action was not intended to apply to companies which were chartered by other states and doing business in New York, but it was not long before laws dealing with this class were added.

Since at this period insurance companies were the only foreign corporations which did business of any importance within the state, the laws were made applicable to this class alone. A law passed in 1824² stipulated that any person who thereafter acted as an agent for any individ-

¹ New York Statutes, 1814, Chap. 49.

² New York Statutes, 1824, Chap. 257.

ual or association of individuals which was not incorporated under New York law, (even though they were formed under laws of other states) for the purpose of carrying on a fire insurance business, must render to the comptroller an annual sworn statement of the amount of premiums which he or any other person had received for insurance effected by him. The statement was to be for the year ending September first, and on or before February first he was to pay into the state treasury ten per cent on the amount of all premiums. To insure that the stipulated returns would be made a bond of one thousand dollars was required of every agent. If such were not furnished within three months after the passage of the act he was to be fined five hundred dollars. This was the system by which the foreign companies were taxed until 1837 when the law³ was modified so as to reduce the tax on premiums from ten per cent to two per cent. Domestic companies came under the general corporation tax law of 1823 and were taxed upon capital stock while the foreign ones were taxed upon premiums received. This lack of uniformity in the basis for the tax was not accepted as entirely satisfactory by the officials.⁴ In reality, it amounted to a discrimination which operated very unfavorably to the foreign companies, for the taxes imposed proved to be almost prohibitory. A committee was appointed to investigate the taxation of foreign insurance companies and made a report to the legislature in 1847.⁵ They admitted, with some reluctance, that foreign corporations must be taxed upon a different basis from domestic, but opposed a suggested increase in the rate. They held that the citizens of the state and especially of New York City had suffered from the prohibitory taxes which had been placed upon foreign insurance companies. The business interests of the community, they said, required the encouragement rather than exclusion of for-

³ New York Statutes, 1837, Chap. 30.

⁴ The report of the Committee on Banks and Insurance Companies, (Assembly Documents, 1845, No. 80) pointed out that this dual classification of the companies caused trouble in trying to equalize the tax paid by different companies.

⁵ Assembly Documents, 1847, Vo. 8, No. 251.

eign agencies, at least until such time as the state, by wise and judicious laws, should secure the establishment of insurance funds sufficient to meet the exigencies of ordinary business. They even questioned the constitutionality of the law, suggesting that it ran counter to the federal constitution.⁶ Because, then, of the doubtful constitutionality of the law and the wholesale evasions which were practiced under it, they asked for its repeal.

While early legislation was thus distinctly hostile to insurance companies incorporated without the state, the first law dealing with foreign capital in general was of a very different nature. In 1851 the legislature attempted to increase the amount of foreign business carried on in the state. A law passed in that year⁷ provided that products from any state of the United States which were consigned to agents in New York, would not be assessed to the agents. Neither were the agents of moneyed corporations or capitalists to be taxed for any moneys in their possession or under their control, transmitted to them for the purpose of investment or otherwise. Under such an act there is little doubt that there was discrimination in favor of the foreign organizations. Not only was a large part of the money sent here free from tax but practically all goods manufactured outside the state and sent here for sale escaped taxation. The money in the hands of citizens and corporations of the state no doubt escaped taxation to a large extent, which made the discrimination here more formal than real. The exemption

⁶ Federal Constitution, Art. 4, Sec. 21. This provides that the citizens of each state shall be entitled to all privileges and immunities of the citizens in the several states. It has not been held, however, as applicable to corporations. A corporation is an artificial person but not a citizen. Chief Justice Taney pointed out (*Bank of Augusta vs. Earle*) that a corporation could have no legal existence outside the boundaries of the state by which it was created. It existed only by force of law and where the law ceased to operate, the corporation could have no existence. It was by the law of comity among nations, he pointed out, that a foreign corporation was allowed to make contracts and sue in the courts of another state. Neither is it unlikely that a state, thru the exercise of its "police power," could discriminate against foreign corporations so long as it was considered that the protection and welfare of its citizens demanded it.

⁷ New York Statutes, 1851, Chap. 176.

of goods sent to the state, on the other hand, worked as a burden upon the domestic producer since the home-made goods could not easily escape taxation yet had to compete with the goods which were sent into the state. The law in this form, however, was of short duration. In 1855 a statute⁸ was passed which provided that all non-resident persons and associations doing business in the state, as merchants or bankers, whether as principals or as agents, should be assessed and taxed on all sums invested in such business as if they were residents. Although this law did not affect money sent here to be invested yet it eliminated to a great extent the other forms of discrimination which existed under the previous law. There was at least an attempt to place foreign corporations upon a par with those incorporated under the New York laws.

It soon became evident that both the general law and the one affecting insurance companies needed interpretation by the courts at some points. The assessors had put upon the assessment roll the amount deposited with the Comptroller as a prerequisite to doing business in the state.⁹ The British Commercial Company refused to pay the tax upon this and carried the case to the Supreme Court.¹⁰ which held that securities so deposited were to be considered as an investment and were liable to assessment and taxation.¹¹ It was also necessary that the courts make some determination with regard to the situs of property. Any personal property of a non-resident which was located in the state was liable to taxation, with only such exceptions as the statute law had made.¹² This

⁸ New York Statutes, 1855, Chap. 37.

⁹ Chapter 95, New York Statutes, 1851, required a deposit of one hundred thousand dollars in securities with the comptroller.

¹⁰ *British Commercial Life Insurance Company vs Commisioner of Taxes*, 28 Barbour, 318.

¹¹ In 1853 (New York Statutes, Chap. 463) the requirement of a deposit with the comptroller was repealed, and the court held (*People vs New England Mutual Life Insurance Company*, 26 N. Y., 303) that even though some corporations did not immediately withdraw the securities, they were no longer taxable as money invested in the state.

¹² *Hoyt vs Commissioner of Taxes*, 23 N. Y., 224.

was to apply only to property which was capable of having a situs and which really had one. Property in transit through the state for instance, was not taxable. In another case ¹³ it was held that goods which a non-resident owner had sent to the state for the purpose of sale, without reinvesting the proceeds, were not liable to be taxed. The act, it held, was only designed to reach the capital of non-residents which was employed in the state in a continuous business, and not property sent merely to find a market. The last two decisions were reversals of the opinions of the lower courts and increased inequalities between domestic and foreign producers.

By a law of 1862¹⁴ life and health insurance companies from without the state were put upon the same basis as other insurance companies, especially in regard to the two per cent tax on premiums. In 1865 the attitude of the legislature towards retaliatory methods was shown. Some states it seems, had been discriminating against New York insurance companies. A law ¹⁵ was passed aiming directly at such states.¹⁶ It provided that if any state imposed greater penalties upon an insurance company incorporated under New York laws than upon its own companies, then equal penalties should be imposed upon companies from that state doing business in New York. The state of Pennsylvania required a payment of three per cent of the premiums received by a foreign in-

¹³ *Parker Mills vs Commissioner of Taxes*, 23 N. Y., 242.

¹⁴ New York Statutes, 1862, Chap. 300.

¹⁵ New York Statutes, 1865, Chap. 694.

¹⁶ The general facts with regard to retaliatory insurance taxation are well known. To a greater or less degree the majority of the states have used this weapon against foreign insurance companies. In 1910 the National Tax Association adopted a resolution to the effect that a uniform method of taxing premiums, both foreign and domestic, should be adopted by the several states. Hon. Geo. Curtis, at a general public hearing on the report and bill of the Wisconsin Tax Commission relating to the taxation of life insurance companies reviewed the facts and effects of "retaliation" taxation upon insurance companies. He thinks such laws have often served a just purpose, and if their existence and enforcement would tend to secure the needed uniformity, it would be an additional reason for their retention. If the laws should become uniform, then the retaliatory effect would become inoperative.

surance company. Because of this the court held¹⁷ it justifiable that New York should demand the same percentage of premium from a company incorporated in Pennsylvania.

The scheme of taxing foreign corporations was, however, far from satisfactory. The court had decided¹⁸ that the part of the law of 1851 which exempted from tax the capital in the hands of agents for the purpose of investment was not repealed by the act of 1855. A large amount of capital which practically escaped taxation continued to come into the state.

The practice which foreign banking houses followed is a good illustration. They would have a permanent agency established in the state to which they would send money to be employed in temporary loans. Since they were subject at all times to the control of the home office, such funds were held to be exempt from taxation. A large number of banking houses of other states and Canada established such agencies. They came and received the protection of the laws, courts, and police, yet paid no taxes. This was a discrimination in favor of foreign capital since the domestic institutions of the same kind were taxed, at least upon their capital which, in part, was the basis of their ability to extend loans. In addition to the local burdens, national banks had to bear the tax imposed by the federal government. Because of the tax, the profits which the foreign representatives received were greater than the domestic houses realized upon similarly employed capital. Year after year the state assessors and comptrollers pointed out the evils and asked for reform. They did not ask for legislation which would make it difficult for foreign capital to come to the state, but for some measure which would put all upon an equal footing. "The owners of foreign capital," said the assessors, "would have no cause for complaint if taxed in the same manner as citizens, but citizens have a just cause

¹⁷ *People vs Fire Association*, 92 N. Y., 311. Affirmed, 119 U. S., 110.

¹⁸ *Bank of Montreal vs Commissioner of Taxes*, 59 N. Y., 40.

for complaint when the laws favor foreign capital.¹⁹ The noted tax commission which reported in 1871²⁰ recommended that foreign insurance companies be assessed and taxed under the laws which applied to domestic companies, and that thereafter the same statute should apply to both.

To illustrate the way in which the law as interpreted worked, we shall notice the case of the Manchester Plate Glass Company. This was an English concern which maintained a store in New York City. They were assessed \$150,000 upon goods not contained in the original packages in which they were imported. The assessment was not allowed to stand because the proceeds from the sales were not invested here but were remitted to the foreign house. In reality, the way in which the law was enforced and interpreted placed no tax upon the foreign banking business carried on in the state, while domestic capital used in the same business was taxed.

The products of foreign manufacturers, under certain conditions easily complied with, were exempt from taxation while the domestic manufacturers of similar articles were taxed. The Commissioner of Taxes and Assessments for New York City, in his report for 1877²¹ says that if the purpose were to specifically protect foreign capital and foreign industries at the expense of home capital and industries no more effective law would be needed. He asked for some equalizing remedy—either to tax foreign industry or remove the burden from home industry.

Finally, in 1880, the legislature responded to these demands and passed two laws, one relating to the taxation of foreign bankers²² and the other to fire and marine insurance companies.²³ The first of these stated that every

¹⁹ Annual report of the State Assessors, 1880, Senate Documents, 1880, Vol. 1, No. 26.

²⁰ Assembly Documents, 1871, Vol. 3, No. 265. See note. p. 16.

²¹ Annual Report, Commissioner of Taxes and Assessments, New York City, 1877.

²² New York Statutes, 1880, Chap. 596.

²³ New York Statutes, 1880, Chap. 542.

organization, created under laws other than those of New York, and in any manner engaged in banking business in the state, was to pay annually to the state comptroller a tax of one half of one per cent on the average of all sums of money used in the state during the year. The organizations were required to make returns which would give the proper data upon which to base the assessment. As a penalty for any failure to make the required returns, the law provided that ten per cent of the amount of the tax should be added. With regard to fire and marine insurance companies, it was provided that such organizations, created without the state, should pay a semi-annual tax of eight-tenths of one per cent on the gross premiums which they received from business transacted within the state during the previous six months. They were to make semi-annual reports which would show the amount of the premiums they had received. Lands and real estate were to be taxed where situated, but capital stock and personal property were to be exempt. We note here the introduction of the semi-annual payment of the tax, a feature which is in use in many of the western states with all taxes, but which we do not generally find in New York. In these two laws opposite tendencies are quite marked; in the case of banks, a tax was imposed which did not before exist while in the case of fire and marine insurance companies the tax was reduced. Foreign corporations, other than those just discussed, were affected by the general corporation tax legislation of 1880 and 1881. By this, the capital of foreign corporations as well as that of domestic corporations was made subject to the annual franchise tax. The court held,²⁴ too, that the basis of the annual franchise tax for foreign corporations was the entire capital and not the portion of it which was employed within the state. Such a principle was unquestionably unjust, but such was the law until 1885. In that year the legislature limited the franchise tax to the amount of capital employed in the state.

This legislation did not receive the approbation of the foreign corporations. Shortly after the passage of the

²⁴ *People vs Horn Silver Mining Company*, 105 N. Y., 76.

law representatives of these organizations met in the Metropolitan Hotel to take some action of protest against the tax levied upon their capital stock. It was claimed that the law under which they were required to make statements to the comptroller in regard to their business was a discrimination against them. The tax was collected directly by the comptroller and was based entirely upon the success of the business. The reports which were required worked a hardship upon them since it threw their business open to the inspection of their competitors. Such were some of the grievances and the meeting resulted in the unanimous adoption of a resolution instructing a committee to prepare petitions to the legislature asking for the repeal of the laws. Every corporation interested was assessed one-fourth mill on every dollar of their capital stock to pay the expenses of such suits as might be instituted by the comptroller to enforce the payment of taxes under the law. The results of this meeting show that the foreign corporations were not going to surrender the privileges which they had enjoyed without a fight, and subsequent litigation shows that they made use of the one-fourth mill assessment.

As might be expected the new legislation caused a large amount of litigation. A few cases will suffice to illustrate the nature of the difficulties left for the courts to decide. One of the troublesome problems was to determine when a corporation was doing business in the state. The American Bell Telephone Company had been carrying on a business in the state through local companies acting as its agents. It had no officers but did its business entirely through agreements made with local companies. Because of this arrangement, it claimed that it was not doing business here under the meaning of the law. The lower court held²⁵ that in order to render any company taxable, no proportionate amount of its business was required to be transacted in the state. If any of its business had been carried on in any way, it was liable to

²⁵ *People vs American Bell Telephone Company*, 50 Hun, 114.

the tax. The Court of Appeals²⁶ refused to take this view and held that where the foreign company had leased and licensed the use of telephones in the state under contract between the parties, it was not carrying on business under the meaning of the act. The business which was carried on, it held, was being carried on by the local companies and they were subject to the tax. In another case²⁷ it was held that a company which was organized under the laws of another state and which had property in New York, could not claim exemption from taxation on account of the laws of its own state.

The question of interference with interstate commerce was one which very frequently arose. Of the multitude of cases which came before the courts we shall note but two typical ones. A manufacturing company which did a part of its business in the state claimed that the regulation of commerce between states was the sole prerogative of the federal government, and that the taxation violated this principle. The Court of Appeals held²⁸ otherwise and ruled that there is no limitation upon the power of a state to exclude a foreign company from doing business within its limits, or to exact conditions for such privilege, save when the corporation is in the employ of the federal government or where its business is strictly commerce. The fact that legislation upon the subject might indirectly affect commerce did not render it unconstitutional. Property engaged in foreign or interstate commerce, might be taxed the same as domestic property but no more.

The other case which we shall notice was one involving the Pennsylvania Railroad. The line of the company extended into other states but not into New York. It operated a ferry in connection with its road across the Hudson

²⁶ *People vs American Bell Telephone Company*, 117 N. Y., 241. In New York the Court of Appeals is the highest court and corresponds to the Supreme Court of many states.

²⁷ *People vs Coleman*, 135 N. Y., 231. The court here said that it seemed the legislature might constitutionally impose double taxation but its purpose so to do may never be inferred, but must plainly appear.

²⁸ *Southern Cotton Oil Company vs Wemple*, 131 N. Y., 64.

to the city of New York where it had terminal facilities. It used these facilities for receiving and delivering freight and passengers. It collected money there for tickets and maintained a large force of workmen. This terminal was assessed and taxed; then the company carried the case to court on the ground that the state was interfering with interstate commerce. The court of Appeals refused²⁹ to allow the tax to stand since the business engaged in was exclusively that of interstate commerce. A foreign corporation which was engaged both in the business of state and interstate transportation in the state was, however, subject to taxation in common with domestic corporations. From these decisions and other similar ones, it seems the court attempted to establish the principle that a state can levy a tax upon property engaged in interstate commerce so long as there is no hostile discrimination against such property. It would seem, however, that property which belongs exclusively to interstate commerce cannot be taxed by the state.

The system thus far devised did not prove satisfactory. The corporations relied more upon evasion than upon the courts in their attempts to escape the tax. Banks made such excuses as, even though they furnished the money, they did no business—that it was carried on by their agent. In other cases they claimed that they used no money. Some refused because they were neither corporations, companies nor joint stock associations “created” under laws other than those of New York, but were formed under “common law” in their native state. Others refused to comply with the law on the ground that they were either partnerships or individuals. These and other excuses which the minds of the legal advisors could concoct were given, instead of making the reports and paying the tax. The law proved to be practically a dead letter since in 1889 only five banks paid any tax. A large number were reaping profits from the state, yet were bearing no share of the public burdens. Each successive report of the comptroller pointed out the evasions and difficulties and asked for modification, but it was not until 1894 that

²⁹ *People vs Wemple*, 138 N. Y., 1.

the legislature attempted to give relief.

In that year a law was passed³⁰ which purposed to deal with the difficulties in regard to the foreign banks. It provided that every foreign banker doing a business in the state was liable for the payment of an annual tax of one-half of one per cent on the amount of business done in the state during the year ending December thirty-first. The amount of business which was carried on was to be computed by finding the daily average for each month, of the moneys received, used, or employed in connection with the business. The aggregate of such monthly averages was to be divided by the number of months in the year. Each bank was to make a report as to the amount of business and tax due to the state on or before February first. In the case of failure to do this, or if the report was not satisfactory, the comptroller was authorized to examine the books and records of the bank for the purpose of determining the tax. A penalty of ten per cent of the tax was imposed when there was a failure to make the report. It further required the institutions to keep the financial accounts of the business so that they could be examined by the comptroller at any time. All taxes and penalties, in cases of failure to pay, were to be recovered by action brought by the Attorney-General. Here we see that the determination of the tax was not left entirely to the banks, but power is given to state officials to investigate and verify reports. This is perhaps the most marked advance over previous legislation.

In 1895 a license tax—corresponding to the domestic organization tax—of one eighth of one per cent was placed upon all foreign corporations (except banks and insurance companies) doing business in the state.³¹ The amount of capital employed during the first year was to be the basis of the tax. In 1896³² the law in regard to

³⁰ New York Statutes, 1894, Chap. 196.

³¹ New York Statutes, 1895, Chap. 240.

³² New York Statutes, 1896, Chap. 908. The difficulty had still remained of bankers claiming they did not come under the law. This law explicitly pointed out that the term foreign banker was to include (1) every foreign corporation doing a banking business in

foreign bankers was so amended as to set forth in detail just who came under the provisions of the act. By an act passed in 1892³⁴ the capital of any insurance company, incorporated under the laws of any state or country outside of New York, to the extent employed in business in the state was to be subject to taxation the same as the capital of a like domestic insurance company. Such taxation was to take place where its principal office was located. By this same law all foreign insurance companies,—life, health, marine—doing business in the state, were to pay two per cent of all premiums received.

The license fee of one eighth of one per cent brought results which were immediately noticeable. The law, in reality, did not go into effect until the first of December, yet the tax received for the month was over \$1300. Four companies which had been organized without the state, yet did practically all the business here, immediately reorganized under New York laws. Not only did the law produce a license tax, but it greatly increased the organization tax since the inducement of a low organization tax which other states held out was no longer a gain to a company which had most of its business in New York. The total organization tax received by the state in 1895 was \$258,464 while in 1896 it amounted to \$503,951. The Comptroller, in his reports for 1895 and 1896³⁵ was very enthusiastic concerning the good effects of the license fee. In the second of these reports he pointed out that in addition to the increase from licenses, the state had received a large increase of the capital stock tax. This was because many corporations, which would otherwise have escaped notice, were brought to the attention of the department through the payment of the license.

These modifications in the laws caused an increased

the state except national banks; (2) every unincorporated association of two or more individuals organized under the laws of another state or country; (3) every association of two or more individuals, if the members owning more than half of the interest or entitled to more than half of the profits were non-residents; (4) every non-resident doing a banking business in his own name.

³⁴ New York Statutes, 1892, Chap. 690.

³⁵ Annual Reports, New York State Comptroller, 1895 and 1896.

amount of litigation. A few cases will serve to illustrate the nature of the questions which arose. Some domestic corporations sought to evade taxation by consigning their property to agents. The lower courts held that such property was not exempt but was taxable to the agent. The Court of Appeals held that such property was taxable, but that it should be assessed to the corporation at the place where it was located.³⁶ Difficulties arose in placing a value upon the capital of foreign corporations for the purpose of taxation. In such evaluations the court held³⁷ that the par value of the stock was to be used as the proper basis.

The questions as to what effect the good will, debts and surplus of foreign corporations had upon their valuation were left for the courts to decide. Where the good will enjoyed by one firm was transferred to a corporation organized to continue and take over the business, such good will was an asset and was to be considered in determining the amount of capital employed in the state. In fixing the amount of the capital the same proportion of the value of the entire good will was to be taken as the amount of the tangible capital employed by the corporation in the state bore to the entire amount of tangible capital³⁸ Copyrights granted by the government, however, were held to be without the taxing power of the state.³⁹ Some companies had purchased property in the state and had not made full cash payments for it. When such purchases were made, so held the court,⁴⁰ and the company paid cash for a part and promised to pay the balance in the future, or paid no cash but promised to pay in the future, the amount still due upon the property was to be deducted from the value of the property in order to ascertain the "sum invested" in the state upon which the law held them taxable. In case all the corporate property and business of a foreign company were in

³⁶ *Boardman vs Supervisors*, 22 Hun, 231; 85 N. Y., 359.

³⁷ *Elliott-Fisher Company vs Lohmer*, 206 N. Y., 10.

³⁸ *Koecht and Company vs Morgan*, 183 N. Y., 359.

³⁹ *Johnson Company vs Roberts*, 159 N. Y., 70.

⁴⁰ *People vs Barker*, 147 N. Y., 31.

the state, the corporation was entitled to have the amounts of its debts deducted from the amount of capital employed in the state.⁴²

The question of dealing with the surplus arose in several cases. A West Virginia advertising company was incorporated for \$5000 but was employing \$40,000 in New York. The comptroller fixed the basis of the tax at \$40,000. The court ruled that no matter how great the aggregate property of a corporation was, the "capital stock"—the basis of the tax—could not exceed the amount authorized by the charter. The company might employ surplus and not increase capital stock, and the surplus not be subject to taxation.⁴³ At another time the court held that surplus earnings of a foreign company, carrying on a portion of its business in the state, which were invested in real estate, could not be taxed.⁴⁴

The attitude of the court in the McLean case has made it difficult to collect taxes from foreign companies. No action it held, could be taken against the person so there is left only the recourse of proceeding against the property. That such has been ineffective is shown by the fact that from 1901 to 1913 the annual tax collected for non-residents in New York city decreased nearly fifty per cent.⁴⁵

These laws, as thus interpreted, constitute essentially the present system of taxing foreign corporations. We have the general law covering all classes, and special legislation in the case of banks and insurance companies. A little consideration of the above interpretations will convince one that they provide the way for the escape of much capital which the law intended to tax. That a large amount of evasion was being practiced was pointed out by the Comptroller in his report for 1895.⁴⁶ He had been convinced by a little tentative work that several thousand taxable foreign corporations employing a whole or a portion of their capital in the state, were not yet upon the

⁴² *Journeay vs Roberts*, 27 Supreme Court, App. Div., 1.

⁴³ *Advertising Company vs Roberts*, 151 N. Y., 621.

⁴⁴ *People vs Wemple*, 150 N. Y., 46.

⁴⁵ *City of New York vs McLean*, 170 N. Y., 374.

⁴⁶ Annual Report of New York State Comptroller, 1895.

comptroller's books. Many had failed to secure a certificate authorizing them to do business in the state, and such could only be discovered by personal examination. The license tax to some extent alleviated the difficulty but by no means eliminated it.

The exemption of the surplus paved the way for as much evasion of the tax as any other feature of the system. Corporations are not slow to claim that the money employed in the state is surplus and that the real capital is invested outside of the state. They claim that they are exempt from taxation because they have more surplus than the amount used in New York. A New York citizen might incorporate in another state for \$5000 and by issuing bonds or establishing a so-called surplus, practically escape taxation. It was an incentive to under-capitalization for by such organization a surplus was automatically created. Numerous suggestions for reform were made.

In his report for 1898,⁴⁷ after pointing out the conditions, the State Comptroller made the suggestion that they should cease trying to tax the capital stock created by the laws of another state. He considered it would be better to assess an annual tax upon the right to do business in the state. He suggested, as the measure of this taxation, such part of the authorized capital stock of the foreign corporation as its tangible assets in New York state bore to its entire tangible assets. He even went so far as to incorporate these recommendations in a bill which he had introduced into both houses of the legislature. It was aimed at the practice of corporations going to another state and incorporating for perhaps several million dollars while their entire business in New York was carried on with only a few thousand dollars in capital stock. The bill did not pass, and the Governors' messages's⁴⁸ and comptroller's reports continued to point out

⁴⁷ Annual Report New York State Comptroller, 1898, Assembly Documents, 1898, Vol. 1, No. 3.

⁴⁸ Governor Odell, in his message to the legislature in 1902 (Senate Documents, 1902, Vol. 1, No. 2.) pointed out that certain companies had taken the amount of their corporation holdings in the state and incorporated under the same name and with the same

the inequalities and ask for reform. Not only were the state officials dissatisfied, but the special tax commission which reported in 1900⁴⁹ decried the conditions and asked for reform. In 1906⁵⁰ the legislature passed a bill which was practically the suggestion made by the comptroller in 1898. This remedied the evil of having a large capitalization without the state and only a small amount employed in New York, even though a large amount of the business were done here. It did not, however, remedy the evil of exempting the invested surplus from taxation. A company with a small capitalization might still have a large amount of assets, and yet escape with a comparatively light tax.

The law⁵¹ which exempts from taxation such companies as are employing at least forty per cent of their capital in manufacturing has been taken advantage of by foreign corporations. They organize small companies under New York laws, such organizations often having the same name as the foreign corporation with the words "of New York" added. The foreign company owns all of the share stock of the domestic company, and it frequently happens that the domestic company pays no dividends. The net returns find their way back to the parent foreign corporation. The provision which exempts the goods of a foreign corporation from tax if the proceeds from the sale are transmitted to the home office, no doubt often works as a discrimination against domestic producers. A foreign company can fill a warehouse with goods and keep them as long as it desires without paying a tax, while a

officers as designated in the incorporation in other states. This allowed them to evade taxes for which they would otherwise be liable. He suggested that no corporation be allowed to form with the same name as that borne by a corporation of another state. Governor Higgins (Senate Documents, 1906, Vol. 1, No. 1) contended that a corporation organized elsewhere to do business in the state and which was a foreign corporation in name only, thereby obtained an unfair advantage over the legitimate domestic corporation which incorporated under New York laws.

⁴⁹ Report of Special Tax Commission, Senate Documents, 1900, Vol. 1. No. 7.

⁵⁰ New York Statutes, 1906, Chap. 474.

⁵¹ New York Statutes, 1901, Chap. 558.

domestic company under similar conditions would be taxed. By a law passed in 1900⁵² every foreign banker is required to pay a tax of five per cent on the amount of interest or compensation of any kind earned and collected by him on money loaned, used, or employed in the state.

In dealing with foreign corporations, two conflicting policies have been followed. One has been that foreign capital should be attracted in order to develop large industry within the state. The other tendency has been to protect domestic capital. While each of these proposals has its advocates, it would seem better not to discriminate between the two classes of capital, but to treat all capital within the state under the same conditions, on an equal basis. Only by doing this can it be insured so far as taxation is concerned, at least, that competition will be upon an equal basis. Whatever be the method in use, then, for taxing the domestic corporations, the same should be applied to the foreign. Much has been said about imposing greater burdens upon foreign corporations than upon foreign individuals doing business in the state. The individuals pay a tax upon the property but do not have to pay the license and franchise taxes. But this question no more applies to foreign corporations than to corporations in general. If it be decided that the corporate form gives advantages which enable it to pay higher taxes than the individual, then the foreign corporation should bear them as well as the domestic.

If we had a uniform system of taxing corporations for all the states, then our problems of driving out or attracting capital would be minimized. But since we have such varied systems, the states should endeavor to treat all concerns doing business within their borders upon an equal basis. There would be at least some tendency to uniformity, for the states which imposed harsh burdens upon their corporations would not only keep foreign capital from coming to them, but would tend to force domestic capital outside their borders. As long as New York uses the franchise tax upon capital stock as the basis for taxing a large part of its corporations, this also should

⁵² New York Statutes, 1900, Chap. 500

be used in the case of the foreign corporations. We have seen that the amount of capital stock in the state was considered as that proportion of the whole capital stock which the assets in the state bore to the total assets. We also saw that this was largely evaded by a small capitalization and the use of surplus in the state, which the courts have held could not be taxed. Such evasions should be minimized. One way in which this could be accomplished would be to change the basis of comparison. Perhaps as fair a way as any under the existing circumstances would be to consider both the capital stock and surplus as "capital stock" for the basis of the tax. And so long as classifications of capital stock are made according to the amount of dividends paid, more or less confusion will result. We have pointed out in another chapter the difficulties which this provision occasions. Under the present scheme of apportionment, equality is not always obtained because the dividends accrue only partially from business done within the state. The amount of business which a foreign company carries on within the state bears no constant ratio to the amount of its assets found here. Hence taxation which takes for its basis the capital stock, classified according to the amount of dividends paid, and in proportion to the amount of assets found within the state, is not fair.

Then, too, the provision exempting goods from taxation which are sent here to agents should be modified. As the home producer is made to pay tax upon the goods he has in stock, it is unfair discrimination to exempt the foreign goods. The assessors should be allowed to assess such consignments on the same basis as they assess other goods.

Since for the present at least, we are to use the capital stock as the basis of the tax, the question arises as to the best way of determining the amount "employed" in the state. Can we find a more equitable basis than that of assets? A little investigation convinces us that the entire assets of some foreign corporations consist of an office in New York City. Yet it by no means follows that this represents the importance of New York to the company.

For psychological, economic, or geographic reasons the entire business of the company may be carried on through this office. As much of it may be with New York citizens or foreign countries as if it were a domestic company. Because such company has no assets in the state should it escape taxation? We think not. Perhaps it would not be far amiss to take, instead of the assets, the amount of business transacted within the state as the proper proportion of the company's capital to be taxed. Surely the amount of business represents more the contribution of New York to their ability to pay taxes than does the amount of assets found within the state. The amount of business carried on could be determined from reports from the corporations subject to investigation by the state officials.

The method just outlined would be preferable to an income tax which has been advocated by many. Such a tax would be satisfactory and just, no doubt, if income were taken as the basis of taxation for domestic companies as well. But if we take a percentage of the income from foreign companies while we tax domestic companies on their capital stock, we would be taxing companies carrying on a similar business upon different bases and could not hope to realize the desired equality. If the state should adopt some other method than the capital stock basis for its domestic corporations, then we could apply the same to the foreign companies. Whatever the methods in use, however, it should be applied to both in order that as near an equality as possible be attained.⁵³

⁵³ The Joint Legislative Committee on Taxation, which made a report to the legislature February 19, 1916, pointed out the need for changing the method of taxing foreign corporations. The evils of the present system were enumerated but no remedies suggested. The part of the report dealing with foreign corporations closes: "From every point of view, whether from that of the cost of the service, the benefit derived or the ability to pay, the answer is clear: foreign corporations should contribute liberally to the support of New York State government."

CHAPTER V.

TAXATION OF INSURANCE COMPANIES AND MANUFACTURING CORPORATIONS

In the preceding chapter we noticed that foreign insurance companies were subject to special taxes in New York. This was not at first true of domestic companies which were taxed on their capital stock under the general tax laws of 1823 and 1828. In 1824 the legislature gave a few specified insurance companies the privilege of paying to the treasurer of the county in which they did business ten per cent upon all dividends, profits, or incomes in lieu of the tax on capital stock.¹ The variable nature of the capital stock of insurance companies proved to be a source of difficulty in applying the tax. The matter was brought to the attention of the legislature by the Rensselaer Insurance Company. On June 20, 1820 it had a capital stock of \$199,880.90, but a conflagration loss reduced it to \$87,536.45. In 1821 it was increased to \$101,781.89, but it was still assessed on the amount before the loss. The legislature, upon receiving the company's petition, enacted that the sum last named above should be taken as its capital stock until additions were made to it. The general insurance law of 1849 made provision for uniform reports as to the amount of capital stock and other financial details but made no change in taxation.

The rise of mutual companies created a new problem for the legislature and the courts. Such companies sought to escape taxation because they were not formed under the general law neither had they "capital stock." Attempts to assess capital stock to them led to litigation. The Buffalo Mutual Insurance Company had a fund of \$100,000 invested in securities, the income from which went to

¹ New York Statutes, 1824, Chap. 321.

the policy holders. The company had no other invested capital yet this fund could not be withdrawn or divided. It was virtually a trust fund for the policy holders. The court held that the company was a moneyed or stock corporation deriving an income and was liable to taxation upon such a fund as capital.² The Sun Mutual Company had been accumulating a surplus from premiums paid in by members as a fund from which to meet the losses and expenses that might arise during its existence. Certificates were issued to the members which stated their interest in the surplus fund. The court held that wherever a mutual insurance company accumulated from its profits a fund to continue liable for its losses during the term of its existence, and issued certificates to members stating their interest therein, such accumulation became capital. The certificates were not evidence of debt but represented the interest of the members in the capital, and such a company was liable to taxation upon the capital so accumulated.² A number of other cases that raised virtually the same issues were decided in the same way.³ The legislature finally cleared these issues by first declaring that the

² *Buffalo Mutual Insurance Company vs Supervisors*, 4 Comstock, 443.

² *Sun Mutual Insurance Company vs City of New York*, 8 N. Y., 241.

³ The fees exacted from insurance companies for the performance of certain transactions have varied at different times. In 1853 one law (Chap. 463) provided for fees payable by life and health companies while another (Chap. 466) imposed similar requirements on fire insurance companies. A declaration was to be filed in the office of the comptroller, setting forth intentions to form a company, for which a fee of twenty dollars was to be collected. For depositing their certified charter and securities foreign companies were assessed a like fee. For every paper filed by the county clerk, he was to charge ten cents. Under the act which established the state insurance department in 1850 (Chap. 366) the fees were increased. Thirty dollars were assessed for filing the declaration or certified charter; twenty dollars for filing the annual statement; three dollars for every certificate of agency; one dollar for filing each folio of paper in the office. The fees were to meet the expense of maintaining the insurance department. In case they should fail to do this, the deficiency was to be assessed annually pro rata upon all stock insurance companies of the state. In 1868 (Chap. 732) the fee for filing the annual statement by all marine and life insurance companies was fixed at fifty dollars.

mutual companies were taxable⁴ and later by taxing them on an arbitrary sum of \$100,000 personal property and no more.⁵

For many years, then, insurance companies had been taxed like other corporations, and there is very little indication that it was thought they should be taxed otherwise. Evidence of the growth of a new opinion, however, is found in an editorial of the *New York Times* in 1879:

Insurance companies require distinct treatment. Rules applicable to other corporations are inapplicable to these or to any corporation whose operations involve the exercise of thrift or prudence on the part of the public. Fire and marine insurance companies maintain indeed, certain general resemblances to other forms of business and are not likely to be injured by the taxation of their capital and of so much of their accumulations as may be found in real estate. Life insurance stands upon a different footing. . . . So many of the companies as possess stock capital can be taxed on that item and all of them properly be taxed on the basis of surplus. To the extent of the reserve required for the fulfillment of a company's obligations to its policy holders, the assets are a trust fund which it were criminal to touch. The surplus, though, in a mutual company, belonging to the policy holders may be assessed without danger or injustice; in a stock company where more or less of it may be claimed by holders of stock which never rendered service, the surplus not only may but should be taxed as vigorously as the inflated stock of a railroad company.⁶

Further evidence of dissatisfaction with the situation is found in the report of the State Assessors for 1874. The taxes paid by insurance companies they said were almost negligible as compared with their capital and their business. Comparatively few made the returns required by the tax law.⁷ Again in 1880 the assessors suggested that although the surplus of mutual insurance companies is likely to be largely invested in United States securities which cannot be taxed directly, yet it is within the power of the legislature to use the amount of the surplus as the measure of a franchise tax. The taxation of such companies, they held, should not be repressive, for the business of insurance should not be discouraged. They

⁴ New York Statutes, 1853, Chap. 469.

⁵ New York Statutes, 1855, Chap. 83.

⁶ *New York Times*, Apr. 8, 1879.

⁷ Annual Report New York State Assessors, Senate Documents, 74, Vol. 1, No. 23.

thought it no more than fair, however, that the companies should pay something to the state which created and protected them. They suggested a tax of one per cent or three-fourths of one per cent upon so much of the surplus as exceeded one year's income. The measure of a year's income was to be the average income of the five years preceding.⁸

In 1880 the legislature passed an act⁹ taxing life insurance companies. This placed an annual tax upon the franchise or business of every life insurance company incorporated under the laws of the state. The tax was to be paid before February 1 and was to be one per cent upon the gross amount of premiums, interest, and other income, exclusive of rents, received by the company during the year ending with the preceding December 31, from persons residing in the state or from investments represented by or based upon property situated within the state. Land and real estate were to be assessed locally, but the personality and stock was to bear no tax. At the same sitting of the legislature, similar provision was made for other forms of insurance companies.¹⁰ Each of these companies was to pay a tax of four-fifths of one per cent upon the gross amount of premiums. This was not at first specified as a franchise tax, but the next year the legislature so defined it.¹¹

The tax on life insurance companies did not prove productive. Although it was not repealed until 1887¹² it

⁸ Annual Report New York State Assessors, Senate Documents, 1880, Vol. 1, No. 26.

⁹ New York Statutes, 1880, Chap. 534. Every company was to make a sworn statement to the state treasurer giving the total amount of premiums, interest or other income as was the basis of the tax. The refusal or neglect to make the report was declared a misdemeanor, and any one who wilfully made a false statement was to be subject to the penalties of perjury. Unpaid taxes were to be collected by action of the attorney general and the Supreme Court was given the power to restrain business through an injunction until the taxes were paid. In the case of other companies ten per cent was to be added to the tax if the report was not made within thirty days of the specified time.

¹⁰ New York Statutes, 1880, Chap. 542.

¹¹ New York Statutes, 1881, Chap. 361.

¹² New York Statutes, 1887, Chap. 699.

was ineffective, because it lacked a provision stating its purpose. In 1886 the Court of appeals held¹³ that the constitutional provision prohibiting a tax unless its purpose were specially stated did not apply to special taxes. This made the law valid and the companies liable for all the taxes which had accrued under it. The Comptroller asked for a law which would require a payment of only a part of the taxes due under the law of 1880¹⁴ but the law of 1887 repealing this also released the companies from liability for these back taxes. Hence life insurance companies were paying practically nothing directly to the state during this period.

Some modifications were made in 1886 in the taxation of fire and marine insurance companies.¹⁵ They were required to make annual instead of semi-annual returns and the tax, which was expressly stated to be a tax upon corporate franchise or business, was to be one-half of one per cent of the gross amount of premiums received during the year. In 1905¹⁶ this was raised to one per cent on the amount of premiums and life insurance companies were put upon the same basis. By this law foreign and domestic companies are treated alike except for fees and retaliatory taxes.¹⁷ Alien companies, however, are required to pay only one half of one per cent upon premiums.

When insurance companies were taxed like other corporations it was often difficult to determine just what was to be considered as capital and surplus. A large amount of litigation developed, and in almost every case the decisions of the court followed the contentions of the state. A fire insurance company sought to escape taxation on the amount of money received for unexpired fire policies.

¹³ Cited as authority, *People vs Supervisors*, 17 N. Y., 239.

¹⁴ Annual Report of State Comptroller, Senate Documents, 1887, No. 48.

¹⁵ New York Statutes, 1886, Chap. 679.

¹⁶ New York Statutes, 1905, Chap. 94.

¹⁷ Retaliatory taxes aim to get even with other states imposing taxes on New York insurance companies. The law states that New York will impose as high taxes on the companies of any state doing business within the state as are imposed against New York companies in that state.

The court held,¹⁸ however, that so much of this as was in excess of a sum sufficient to cover the contingent liability of the company was to be counted as surplus. One company sought to evade taxation by issuing scrip to the policy holders and retaining the fund. The court held that this was properly included in the assessment of the company.¹⁹ Neither would the court sanction the idea that the surrender value of policies constituted a debt which should be deducted,²⁰ or that the shares should be assessed at the rate at which they sold in the open market during the year.²¹ A number of other cases came up but 410.

these suffice to show the way in which the nature of the business of insurance enhanced the difficulties of reaching a proper assessment. The consensus of the court decisions was that all the assets of the company over and above the contingent liabilities were to be taken as the proper basis for assessment. So far as clearness and ease of administration are concerned, the present system is much better.

To what extent insurance companies, and life insurance companies, in particular, should be taxed or whether they should be taxed at all, are questions upon which there is great variance of opinion.²² New York legislators have pursued a more lenient course than has often been advocated. It is often contended that insurance companies should be taxed only very lightly, if at all, since the burden falls upon the policy holder. When a tax is placed upon a fire insurance company it must mean, in general, a higher premium, to the insured and in many cases a still further shifting until the incidence is upon

¹⁸ *Insurance Company vs Commissioner of Taxes*, 76 N. Y., 64.

¹⁹ *American Fire Insurance vs Commissioner of Taxes*, 91 N. Y., 670.

²⁰ *Insurance Company vs Davenport*, 91 N. Y., 574.

²¹ *Knickerbocker Fire Insurance Company vs Coleman*, 44 Hun,

²² For discussion of insurance taxation see: *State and Local Taxation*, 1907, 1909; paper by F. L. Hoffman, *National Conference on Taxation*, Buffalo, 1901; *Yale Readings in Life Insurance* by Zartman; *Life Insurance and Other Subjects* by Dryden; Reports of special tax commissions of various states, especially Virginia, Nebraska, and Wisconsin, give discussions on insurance taxation.

the consumer in the form of higher prices for the goods that he buys. Much the same objections are made to taxes upon life insurance companies. Life insurance, it is contended, is an institution which makes for the public welfare, and the decrease of the burdens of government in providing for many people who might otherwise be dependents. This general point of view has been well expressed by the *Independent*.²³

A tax on any interest of any life insurance policy holder is indefensible. It closely approximates a tribute laid upon a cemetery lot. To the vast majority of men a life insurance premium is a sacrifice; in varying degrees it represents extra effort or self-denial. It is a burdent upon which the unwisdom of legislation lays another burden. This mistake is due to ignorance—to a confusion of ideas. Men are often misled by names, missing the nature of the things the names represent. It is fairly probable that life insurance accumulations would be exempted from taxation if from the beginning they had been called burial funds or widows and orphans or old age pension funds. That is exactly what they are. There is prevalent, even among policy holders, an erroneous idea respecting the nature of the vast accumulations held by the combined companies. They carelessly look upon them as vast accumulations of surplus wealth. This comes from the fact that they are concentrated and the amount is exceedingly large, and yet in the usual meaning of the terms they are neither wealth nor surplus. They are every dollar of them, expense funds, small contributions of hard earned money saved up against the time when the universal enemy shall desolate the households of the contributors. Not a penny of the money dedicated to such use should be seized by the government.

This is not wholly an inaccurate picture of the nature of the life insurance business. Yet it is greatly exaggerated. By no means are all premiums paid by those to whom such payment is a heavy burden nor is it always done for "burial funds." This is true at best only of industrial insurance. Many persons use the insurance policy as an investment or savings device upon which the reflected tax in an increased premium would not be a material burden.²⁴

The opponents of life insurance taxation follow the line of argument that has been indicated. The beneficent

²³ *Independent*, May 8, 1913, Vol. 74.

²⁴ That a tax is shifted to the policy holder is generally recognized. It is a cost of insurance. In participating companies it is reflected in lower dividends while in non-participating companies the premiums are higher than they would otherwise need to be.

features of the system are extolled; the provision for widows and orphans is emphasized; the burden lifted from the state in the care of dependents is magnified. Life insurance is pictured as a provision for the future—an incentive to providence and thrift. The assets of the companies are but the accumulated savings of the policy holders. A tax upon life insurance, then, they claim, is a tax upon savings, a penalty upon thrift and falls where it is particularly burdensome. This is not merely unjust but it has the further ill effect of diminishing the volume of life insurance.

If we carry this argument to its logical conclusion it would condemn a large part of the present general system of taxation. "Taxes upon life insurance are upon thrift and savings." But the general property tax is precisely such a tax. Men make provision for the future by accumulating savings and capital and are penalized for doing this by a tax. One may put his savings into a house, another may take out an insurance policy. It is hard to see enough difference between the two classes to afford a basis for discrimination between them in the matter of taxation. A tax upon insurance is not a unique tax; it is logically a part of the general scheme which we have adopted. The contentions of its opponents, carried their logical conclusion, would leave as the basis for our taxes only those social values which have no connection with individual savings. In regard to this tax upon savings and thrift, Professor T. S. Adams says:

It is perfectly true that a tax on insurance paid by the policy holder tends to discourage thrift. But that is not in itself sufficient reason for abolishing such taxes. In the first place, our tax system similarly discourages thrift at many points; savings banks are taxed in most states; and the small homesteads in which wage-earners and salaried clerks invest their savings are more heavily taxed in all probability than any other class of property except the estates of widowed and orphaned children in the process of administration and settlement. In fact, our whole system of state taxation, falling principally on realized or accumulated wealth, is a huge engine for the taxation of savings and capital—the two principal means by which thrifty people provide against future emergencies. An insurance is merely a method of co-operative saving with an ingenious provision that if any co-operator is prevented by death from continuing his saving, the more fortunate survivors shall do a stipulated amount of saving for him. Furthermore, this system of taxing savings,

and accumulated wealth has been deliberately adopted and will not be abandoned. The civilized nations of the world have committed themselves to the general policy of levying taxes, so far as possible, in proportion to ability, not disability; according to strength, not weakness; and as the thrifty man is usually the able and strong man, he will continue to pay most of the taxes. . . . The simple truth is that no instrument of social reform is in general more ineffective, more disappointing or more illusory than taxation. Every tax has some incident or collateral social effect. This truth furnishes sufficient reason perhaps, why we should temper or shade the general rule here or there. But it provides no justification for the essential modification of the general rule.²⁵

Another objection to life insurance taxation is voiced in the old cry of "double taxation." The assets of the insurance companies are securities—mere evidences of ownership. The property which they represent is already taxed to the corporation which issued them and should not be taxed to the insurance company. We have noted elsewhere that "double taxation" is not in itself necessarily an evil, but is only such when it leads to an unjust distribution of the aggregate burden of taxation.

Whether securities as a whole should be exempt from taxation is one question; how we are going to tax insurance companies, if at all, under the existing system of taxation is quite a different question. The majority of states have not seen fit to exempt from taxation, securities in the hands of individuals. There seems to be no reason for exempting a company which makes similar investments. In fact it merely acts as middleman for the investor. It seems rather absurd to say to a man, "If you invest \$5000 in bonds we will tax you upon it, but if you let the insurance company invest it for you we will not tax you." If a remedy is needed here it is not in insurance taxation but in the general scheme.

Even if we grant that life insurance should be fostered by minimizing the burdens placed upon it, we cannot go so far as to justify an entire exemption from payments to the state. If life insurance companies are to serve their purpose, their solvency must at all times be absolutely assured. Experience has shown that this necessitates thorough-going state regulation. New York has main-

²⁵ Address before the fourth annual meeting of the Association of Life Insurance Presidents, Chicago, 1910.

tained an insurance department for this purpose since 1857. Such a department, however, should go further than merely to certify that companies are solvent. It should guarantee that the premiums charged are no higher than are reasonably necessary to properly carry on the business. When the state certifies to the solvency of a company and the reasonableness of its premiums, it is performing a special service for particular individuals—the policy holders and their beneficiaries—and it is but just that they should bear the expense.

Taking into account both the nature of insurance business and our present system of taxation, we cannot grant the contention that the treatment of life insurance companies should be especially lenient. The problem is to hit upon some form of taxation which will be equitable as between insurance and other forms of investment. The difficulties are increased because of the fact that individual companies do business in so many different states and because of the various forms of insurance companies. The length of time a company has been in existence is another factor which must be considered. We must also avoid erroneous premises upon which arguments for the taxation of insurance companies are sometimes based. Premiums are sometimes called "income," which is no more accurate than to call the deposits in a bank its income. Then it is often thought that the "dividends" to policy holders are a measure of the profitableness of an insurance business. These are not comparable to dividends paid by an ordinary business corporation to its stockholders, but are merely a return of part of the premium, which, for the sake of absolute safety, has been larger than really necessary.

The "cash surrender value" feature of most modern insurance policies would in itself seem to make them a legitimate part of the basis of the present system of taxes. Like a bank deposit, this is a demand right to money. The fact that the surrender value is less than the aggregate amount of premiums paid in makes no essential difference. The risk that the company has carried has been

paid for by the difference between the surrender value and the premiums paid.

The tax which is now most generally used by the states is a percentage tax upon gross premiums. In New York it is one per cent, which is lower than in most states. Because of its general use and the firm grasp of some sort of taxation upon insurance companies, some insurance officials have asked that the one per cent rate upon premiums be made the uniform rate everywhere.

The premium tax is, however, open to some valid objections. Professor Zartmah has urged²⁷ that such a tax discriminates among policy holders of different states, among holders of different kinds of policies, and among policy holders and other tax payers. The first discrimination results from the premiums employed; the second, from different premiums paid on different kinds of policies; and the third form from the fact that the rate on premiums does not fluctuate with the rate on other property. Because of these difficulties Professor Zartman would give up the premium basis. Any increase in the premium to meet a new tax would work injustice upon future policy holders. The present policy holder has contracted for a fixed premium, and it is only the new policy holder who can be made to pay the tax. This is particularly applicable to stock companies, for in participating companies the tax could be met from reduced dividends. This objection, of course, is not peculiar to insurance taxation but applies equally to many sorts of "new taxes." While the premium tax does work these discriminations, yet it is easily assessed and collected and unless some more just scheme be devised it should not be thrown aside.

No scheme has been devised which mets the theoretical and practical tests of justice. The regulatory expenses can be met by fees and shifted to the policy holders through higher premiums. If New York's personal property tax were other than farcical, a system might be worked out on the basis of the equity of the policy

²⁷ Address before the second annual meeting of Life Insurance Presidents, New York, 1908.

holder represented by the cash surrender value. Should the state adopt an income basis for taxes, it would be comparatively easy to secure franchise taxes by assessing the company's income. The federal tax law has decided what shall constitute the income of insurance companies, and this basis could be used for state purposes. Here the large investments of older companies representing the equity of a large number of paid up policies would continue to be taxed, while under the present system the heavier burdens fall upon the newer companies. Under a general income tax, dividends paid to policy holders and the amount received by the beneficiary in excess of premiums paid could be taxed to the recipient as a part of his income. So long as the present general tax system remains, however, the tax on premiums may serve as well as any other.

TAXATION OF MANUFACTURING CORPORATIONS²⁸

We have seen that in 1817 the policy of using the tax system to encourage manufacturing interests in the state was adopted. In some form or other this policy has been pretty generally followed although not to the full extent that its advocates have urged. This was shown, for example, in the agitation for tax reform in the seventies. The *New York Times* held that the exemption of personal property from taxation in England, France, and Holland was an encouragement to industry in those countries. In this country Maine and Vermont exempted manufacturing capital from taxation. Most of the states, however, New York included, burdened industry with local taxes. This was held to be a disadvantage in competition with foreign producers.²⁹ In his proposals for tax reform presented before the committee of ways and means, October 6, 1874, Mr. George H. Andrews proposed to exempt the shares of all manufacturing corpor-

²⁸ There is no logical reason except that of convenience why insurance companies and manufacturing corporations should be treated in the same chapter. The only point of similarity is that both are exempt from the franchise tax on capital.

²⁹ *New York Times*, Feb. 17, 1871. Editorial.

ations carrying on manufacturing within the state. If for no other reason, he says, the fact that such is the practice in some other states would be sufficient.

In the revision of the tax laws in 1880,³⁰ "manufacturing companies carrying on manufacturing in the state" were exempted from the annual franchise tax. In construing this provision the courts held³¹ that it was not limited to companies organized under the general manufacturing act, but included all companies under whatever law incorporated, whose principal business was manufacturing. The law was applicable to foreign as well as domestic corporations, but where a foreign company only did some incidental work in connection with its manufactured products sent here to fit them for the market it could not claim exemption from taxation under the law.³² The obvious difficulty in regard to companies only a part of whose capital was employed in manufacturing was remedied by the law of 1889.³³ This limited the exemption to corporations whose business in New York was exclusively manufacturing. If a company was not wholly engaged in manufacturing but was also engaged in selling in a city within the state goods manufactured by it out of the state and also of selling articles not of its own manufacture, it was subject to the tax.³⁴ It still remained difficult, however, to determine in particular cases whether a company was engaged in "manufacturing."

At the request of the Comptroller³⁵ the law was amended in 1896³⁶ so as to exempt that part of the capital of domestic and foreign manufacturing corporations which was employed in manufacturing, thus putting foreign and domestic companies on an equal footing. It did not however remove the difficulty in deciding what the term "manufacturing" included. Companies engag-

³⁰ New York Statutes, 1880, Chap. 242.

³¹ *Gas Light Company vs Brooklyn*, 89 N. Y., 409.

³² *People vs Wemple*, 138 N. Y., 582.

³³ New York Statutes, 1889, Chap. 353.

³⁴ *Western Electric Company vs Campbell*, 145 N. Y., 587.

³⁵ Annual Report of New York State Comptroller, 1896.

³⁶ New York Statutes, 1896, Chap. 908.

ed in both manufacturing and merchandising were exempt from tax upon the amount of capital employed in the former use but not in the latter. How were the officials to decide how much was invested in each? The court opinions were apparently conflicting. A law of 1901,³⁷ however, makes it necessary that at least forty per cent of the capital stock of corporations be invested in property within the state and be used by it in manufacturing business if the company is to be exempt from the annual franchise tax on capital stock. A similar provision applies to mining and laundry companies. This simplifies the administrative problem by introducing an arbitrary rule. So long as the organization tax was one-eighth of one per cent a large number of manufacturing companies whose entire business was in New York were chartered in other states. In 1900, the Comptroller reported that 450 such corporations had been formed during the preceding year under the laws of a sister state. The aggregate capitalization of these companies was \$250,000,000.³⁸

Even though manufacturing capital be exempt from the annual franchise tax it is still assessable locally under the law of 1857, providing for taxation of property. When we say that the local officials assess this, we have said enough to condemn the system. If uniformity is needed in any class of taxation it is in the class of manufacturing concerns since theirs is a competitive business, and the tax may mean the margin which will spell success or failure. Then we have all come to know that capital stock, even if it could be properly assessed, does not represent the value of a business. Some companies are doing a large business on a comparatively small issue of

³⁷ New York Statutes, 1901, Chap. 558.

³⁸ Annual Report of New York State Comptroller, 1900. A large amount of condemnation has continually arisen from state officials and the press concerning "driving capital out of the state." In this particular case the capital was employed entirely within the state which, after all, is the important item. Had it not been manufacturing capital, it would have been taxed. Whether "driving capital from the state," when the industry or business is located here, means anything from the standpoint of taxation depends upon the similarity of the laws taxing foreign and domestic companies.

capital stock while in others the capital stock may be to a large extent "water." The latter is especially true in large combinations. There are approximately sixteen hundred assessing districts in the state, and there is no uniform rule to insure equitable assessments of such property. Even if absolute honesty existed among the assessors the magnitude and complexity of the problem would forbid its accomplishment. The officials, however, have often been accused of deliberate discriminations. It has been contended that in some cases capital has been driven away or invited to localities because the assessors either enforced or did not enforce the law. We are well aware that districts often offer incentives to industries, such as free factory sites, etc., and it is not unreasonable to suppose that when they have it within their power, they try to offer advantages in respect to taxation. It is certain that in the local assessment of manufacturing corporations gross inequality still exists.

There is no good reason why manufacturing companies should not bear their share of the public burden. No longer can they be generally considered as infant industries that need the fostering hand of the state. The men who put their capital into such industries have no more claim to exemption than those in other enterprises. The argument that the tax is shifted to the consumer in higher prices is no more applicable here than in the case of many other taxes. The problem of taxing manufacturing companies is the problem of taxing capital in general in a just and equitable manner. The system should be such that there will be no discrimination in favor of particular fields of business endeavor. Because of the nature of the manufacturing business and the extended market for manufactured products, uniformity should not be confined to the limits of any one state but should be extended, so far as possible, to the whole competitive district.

It has been recently contended that the New York system of taxation tends to drive capital from the state or at least offers little inducement for it to enter. In resolutions adopted March 30, 1910 by the Rochester Conference on Taxation figures were cited to show that, from 1900

to 1910, capital invested in manufacturing in New York had increased much more slowly than in Pennsylvania. The proportionate increase of the value of manufactured goods, wage earners and the amount of horsepower developed were similar. The conclusions, however, were based upon census statistics, the accuracy of which may be questioned. The resolutions asked that a committee be formed to further legislation to relieve manufacturing companies. In 1910 the New York Board of Trade and Transportation asked that something be done to remedy the situation. In his message of 1912 Governor Dix expressed his regrets that New York was losing her place as a manufacturing state because of the burdens of taxation. He asked for reform and suggested the federal income tax method as worth considering.³⁹

Differences in the tax system of New York and other states may have had some influence in determining the growth of manufactures. It is certain, however, that too much importance has been attached to this idea. There are many other and more important factors in the situation. Only under the rare conditions that the other influences are practically negligible will taxation be a determining factor. If there were a more rapid growth of manufacturing in Pennsylvania it can doubtless be ascribed to other influences than taxation.

Different methods of taxing this class of corporations have been suggested. Some have asked for a uniform rate upon capital stock graduated by the amount of dividends paid. In 1910 a bill to impose a tax of one-eighth of a mill upon the issued capital stock for each one per cent of dividends paid was reported favorably in the Senate but failed to pass. The main objection was that the dividends would be covered up by high salaries in closed corporations and in others by creating a surplus. Even if this difficulty could be eliminated by charging salaries over a certain amount, together with annual surplus accruals, to dividends, such a tax would not always be

³⁹ Message of Governor Dix, Assembly Documents, 1912, Vol 1, No. 2. The income tax to which he referred has been absorbed by the general federal income tax.

equitable because of differences in capitalization policies.

The problems of taxing manufacturing corporations is but a part of the problem of securing a just and equitable general tax system. There are no longer, if there ever were, reasons why manufacturing corporations should constitute a special class for purposes of taxation. The scheme that may be chosen as just and equitable for capital in general should include capital engaged in manufacturing enterprises.

CHAPTER VI.

TAXATION OF BANKS

In New York, as elsewhere, the taxation of banks by the state has been complicated because of the requirements of federal statutes. On this account a large number of important bank cases have been before the courts. Bank stock was subject to taxation under the provisions of the first special statute relating to the taxation of corporations.¹ Bank officers were required to give to the assessors a statement of real estate, capital stock paid in or secured to be paid in, and the assessors were to put the amount of such real and personal property upon their rolls. The cashier or treasurer was to pay the tax and deduct the amount from the dividends of stockholders in proportion to the amount of stock held by them. As in the case of other corporations, none was to be deducted from dividends due to the state or to charitable institutions. Any complaints which arose were taken directly to the legislature.

Thus, in 1828 the Commercial Bank of Albany applied to the legislature to have its assessments of \$300,000 reduced to \$150,000. This request was granted.² The safety fund system was adopted in 1829, and under this it was necessary that all bank capital be fully paid in. Banks were then taxed upon the amount of their capital (except so much as was held by the state or charitable institutions). The tax was upon its nominal value, even though, of course, its shares might be above or below that value.³

¹ New York Statutes, 1823, Chap. 262.

² New York Statutes, 1828, Chap. 50.

³ So held in *Bank of Utica vs City of Utica*, 4 Paige, 399.

The banking act of 1838⁴ did not state whether banks were to be considered corporations. It remained for the courts to decide that the institutions established under the act were corporations, and that they were liable to be taxed like other moneyed institutions.⁵ Some individuals continued to escape on the ground that they were not corporations. In 1847⁶ the legislature remedied this by providing that all individuals doing a banking business should be subject to tax on the full amount of capital stock. The tax was to be upon the actual market value as estimated by the comptroller, without deduction for the debts of such banker.

In 1851⁷ the banking department was established, the expense of which was to be paid by the incorporated banks in such proportion as the superintendent thought just and reasonable. If, however, any special services were performed for a bank, the expense was to be borne by the bank for which the service was rendered.

In his report to the legislature in 1853⁸ the Comptroller pointed out that the bank surplus was practically the same as capital, and asked that it be taxed in the same way. In that year the general corporation tax law⁹ was passed which made surplus profits or reserve funds in excess of ten per cent of the capital subject to taxation. Since the banking associations were corporations, their surplus, in excess of ten per cent of the capital, was taxable. In 1863, moreover, a law was put upon the statute books which expressly mentioned banks and banking associations as subject to this tax.¹⁰

The most radical change in the taxation of banks came in 1865. This was necessary in order to conform to the

⁴ New York Statutes, 1838, Chap. 260.

⁵ *Thomas vs Dakin*, 22 Wendell, 9 and *Bank of Watertown vs Assessors*, 25 Wendell, 686.

⁶ New York Statutes, 1847, Chap. 419.

⁷ New York Statutes, 1851, Chap. 164.

⁸ Annual Report State Comptroller, 1853.

⁹ New York Statutes, 1853, Chap. 654.

¹⁰ New York Statutes, 1863, Chap. 240.

National Banking Act of 1864,¹¹ which imposed limitations upon the powers of states to tax national banks.

The New York statute of 1865¹² was a general law, enabling banks to become associations for the purpose of banking under the laws of the United States. With respect to taxation¹³ it provided that shares in any of the banking associations organized under the act or the federal statute were to be included in the valuation of the personal property of the owner, and assessed in the town or ward where the banking association was located. Moreover, it was to be assessed at no greater rate than other moneyed capital in the hands of individuals. The tax was not to exceed the par value of the stock, while the real estate of the bank was to be subject to local taxation. Unless the taxes were otherwise paid, the bank was to withhold them from dividends.

Under such provisions, then, national banks began to be taxed. Their shares were assessed and taxed to the individual owners while the capital and surplus of the state banks were assessed to the bank. The first important question which arose was whether bank capital invested in United States securities should be deducted from the assessment. This was the issue in a number of

¹¹ U. S. Statutes at Large, 1864, Chap. 106. It provided, (section 41), that nothing in the act was to be construed to prevent all the shares in any of the said associations [National Banks], held by any person or body corporate, from being included in the valuation of the personal property of such person or corporation in the assessment of taxes imposed by any state authority at the place where the bank was located. Such assessment and tax was not to be at a greater rate than was assessed upon other moneyed capital in the hands of individual citizens of such state. It was further provided that the tax so imposed under the laws of any state upon the shares of any of the associations authorized by the act was not to exceed the rate imposed upon any of the shares in any of the banks organized under authority of the state where such association was located. It further provided that nothing in the act was to exempt the real estate of such associations from either state, county or municipal taxes to the same extent, according to value, as other real estate was taxed.

¹² New York Statutes, 1865, Chap. 97.

¹³ Sections 10 and 11 of the above law.

cases which came before the courts.¹⁴ and the decisions were always against the banks. The point was finally settled by the United States Supreme Court in a case carried from the Court of Appeals.¹⁵ The finding was that shares of banking associations formed by the act of 1864 were subject to taxation by states without regard to the fact that a part or a whole of the capital was invested in national securities. Chief Justice Chase with two other justices dissented, however, in the following language: "We think such taxation is actual, though indirect taxation of the bonds; and that taxation of the shares of national banking associations without reference to the amount of capital invested in national securities, is not authorized by congress."

These same justices dissented in the case of *Dyer vs Commissioner of Taxes*.¹⁶ Here the shareholder object-

¹⁴ The case of the *City of Utica vs Churchhill* (43 Barbour, 550) was one of the first to come before the courts. The court held that a tax on the stockholder for the stock held by him was a proper and legitimate source for state and municipal taxation. A tax upon the stockholder was not to be considered a tax upon the bank nor on its property, but upon property held and owned by the stockholders and in which the bank had no interest. In this case the court held that the laws of the state and not the laws of congress were to furnish the guide by which to decide whether the stocks of national banks can be taxed, and the place and manner of taxing them. The basis for this was that national bank shares were personal property and therefore assessable under New York laws. The court did not think they could be assessed in a ward where the bank was located when residence was elsewhere. In the next session the court took the opposite view (*People vs Assessors*, 44 Barbour, 148) by holding that congress had the power to modify the taxation of national bank shares, and provide under what circumstances it should be excised. The amount of the stock invested in United States securities was not to be deducted. When carried to the Court of Appeals this view was upheld.

¹⁵ *Van Allen vs Assessors*, 33 N. Y., 161, 70 U. S., 573. In the case of *Bank of Commerce vs Commissioner of Taxes* (69 U. S., 200) appealed from the Court of Appeals (26 N. Y., 163) the court held that a tax laid by a state on banks on a valuation equal to the amount of the capital stock paid in or secured to be paid in, was a tax on the property of the institution. When that property consisted of stocks of the Federal Government, the law laying the tax was void. The only difference in the two cases was that one was the assessment upon the capital to the bank, and the other the assessment upon shares to the owner.

ed to the tax because insurance companies were assessed at a much lower rate, or, what amounted to the same thing, were assessed only on the part of capital stock left after deduction of the amount invested in United States bonds. The dissenting opinion held that a similar deduction should be made in the case of bank shares. The majority of the court held, however, that the clause in question did not refer to the rate of assessment upon insurance companies as a test by which to prevent discrimination against the shares; that is, one criterion was the rate of assessment upon moneyed capital in the hands of individuals.¹⁷

While in the Van Allen case the contention of the state courts was upheld, the law of 1865 was, nevertheless, declared unconstitutional. This was upon the ground that it did not provide that the tax imposed should not exceed the rate imposed upon any bank organized by the state. There was no tax laid on bank shares though there was a tax on capital.

This led to the passage of the act of April 23, 1866,¹⁸ which provided that thereafter no tax should be assessed upon the capital of any bank, but that stockholders should be assessed and taxed on the value of their shares. Otherwise the act was much like its predecessor. While this produced no change in the actual results, it met the technical requirements. In making the assessment there was to be deducted from the value of each share such a sum as was in the same proportion to its value as was the assessed value of the real estate to the whole value of the stock outstanding. Each banker was required to give under oath the amount of the capital invested in the business. The bank had to keep at all times in its office a full and correct list of names and residences of all the stockholders together with the number of shares held by each. Such lists were to be open to inspection during business hours.

¹⁷ It was not until later that the interpretation of "moneyed capital in the hands of individuals" came before the court. See page 110 for this case.

¹⁸ New York Statutes, 1866, Chap. 761.

Such were the provisions of the law under which banks were to be taxed for the next several years. As the courts had held that investments in United States securities could not be deducted, so they now further held that debts could not be deducted.¹⁹ In giving this opinion the court said with regard to the law of 1866: "These unusual provisions and directions concur with the previous legislation in indicating the the statuatory intent to establish for bank shares a system of taxation peculiar to itself and independent of the general system of taxation existent in the state." Upon the point of taxing the value of shares it said: "It is as if they had said, we cannot now tax the national banks as we have been accustomed to do but instead thereof we will tax their shareholders and we will apply to them the system of taxation that we have hitherto imposed upon the banks, so far as it is lawful so to do."

Here, then, we have the special system of taxation designed for the banks, and the interpretations made by the courts. The shares were to be assessed to the holders but at the place where the bank was located. Such assessment, however, was not to be at a higher rate than upon other moneyed capital in the hands of individuals. The amount of the stock invested in United States securities and debts could not be deducted. We shall now examine how the policy was received by the banks and the general public, and what were the general effects.

The decisions of the courts which we have just noted were doubtless a surprise to many. Before the cases came before the court, the *New York Times*²⁰ pointed out that the comptroller was making the singular experiment of assessing national bank capital at a higher rate than local bank capital. In doing this it suggested that he was plying directly in the face of the National Banking Act and of course could not succeed. Letters from E. G. Spaulding, drafter of the National Currency Bank Bill

¹⁹ *Cogger vs Dolan*, 36 N. Y., 59.

²⁰ *New York Times*, July 15, 1865.

and the Legal Tender Act,²¹ and Freeman Clark, Comptroller of the National Currency were quoted at length in support of the view taken. Mr. Spaulding concluded that the shareholders of a national bank which has a part of its capital invested in United States securities were only liable to be taxed on the amount of their share in the capital stock remaining after the amount invested in such securities was deducted. If all the capital were so invested he thought the stockholder could not be taxed at all. A lengthy legal opinion by Ward Hunt, printed by the same journal,²² concluded: "Upon a careful consideration of the provision of the statutes, state and national, regulating the shares in national banks for the purpose of taxation, I am of the opinion that such valuation is to be ascertained by taking their actual value subject to a reduction from the shares of each individual of a proportionable amount of the capital invested in United States securities." Taking these views as representative of a probably large body of opinion, we see that the findings of the courts must have been in some measure unexpected.²³

²¹ Mr. E. G. Spaulding was chairman of the Senate sub-committee which drafted the bill providing for the National Currency and the Sub. Treasury Act. Because of his influence in connection with the latter he has been called the "Father of the Greenbacks."

²² *New York Times*, Aug. 3, 1865.

²³ These were the first bank cases which came before the Supreme Court. The first case deciding upon bond investments (69 U. S., 200) arose from the passing of the law of 1863 (Chap. 240). Under the law of 1857 the tax was upon the capital stock assessed at actual value. Here the court held that the amount invested in securities must be deducted. (2 Black, 220) The law of 1863 made the tax upon a *Valuation* equal to the *amount of capital stock paid in or secured to be paid in*. The court reasoned that a tax on such *valuation* was a tax on the property of the bank, and when that property consisted of stocks of the Federal government the tax was void. The other case came under the new law. (70 U. S., 573) Here the court argued that a tax on shares was not a tax on government securities because the tax was the condition for the new rights and privileges conferred upon the associations. If Congress had the power to grant these then it was equally clear that it had power to annex conditions. The tax was not upon securities, but upon the rights and privileges conferred by the charter. Neither was the tax one upon the capital of the bank. The corporation was the legal owner of the property and could deal with the corporate

The law required that the shares be assessed at their actual value, and the court held²⁴ that stock assessed at par value when the market or actual value was more than this was erroneously assessed. Yet there were great irregularities in the assessment of the bank shares. Not only were these taxed differently from other property, but the ratio of assessed to true value varied greatly for different banks. The Comptroller, in his report for 1873, pointed out that the rule of "actual value" assessment was almost everywhere violated. No uniform practice was formed and the valuation was frequently at from twenty-five to eighty-five per cent of par value.²⁵ Only a small proportion of the capital of private banks was assessed, the explanation usually given being that their capital was invested in government bonds.

The state assessors also condemned these inequalities. Not only were the assessments at variance with the actual values, but many different rates of taxes were imposed. Two or three different rates in the same county were not unusual. Negligence of the taxing officials sometimes went further than this. For example, a bank in one of the western counties with a capital of \$200,000 went for several years without being taxed at all, and was finally assessed at one-third of par value.²⁶

Even if bank shares had been assessed according to law, inequality would still have existed as compared with other kinds of personal property. Since they were assessed where the bank was located, and the taxes collect-

property as absolutely as a private individual could deal with his own. In no legal sense were the individual members the owners of the corporate property though they might be interested in it. In the decision dealing with the deduction of debts, (36 N. Y., 59) the reasoning dealt with the legislative interest. It was pointed out that in all previous laws banks were taxed without reference to the condition of the share owners. Where debts were intended to be deducted the laws specifically so stated. It was the legislative intent to tax banks under a different system from that of the general tax law, and the legislature did not intend that debts should be deducted.

²⁴ *People vs Assessors*, 5 Thompson and Cook, 155.

²⁵ Annual Report of New York State Comptroller, 1873.

²⁶ Annual Report of New York State Assessors, Senate Documents, 1874, Vol. 2, No. 23.

ed at the source, it was difficult for bank shares to easily escape taxation. Neither was it possible for banks arbitrarily to designate as their "principal office" a locality where the taxing officials were especially lenient. It was the old question of the evasion of the personal property tax. Since much of the personal property was being assessed at a very small fraction of its "full and actual value," those banks which were heavily taxed had what seems a right to complain. Besides being thus taxed upon capital the banks were taxed upon their whole surplus, which was not true in the case of other corporations. Governor Robinson condemned this practice as unsound since it induced the banks to divide their surplus among the stockholders thereby diminishing the security which it gave to the public so long as held by the bank.²⁷

Such a system could not be without its bad affects. Among the banks of New York City the reduction of capital was a common practice, and along with this went the reduction of surplus. The report of the Commissioner of Taxes and Assessments of New York City for 1877 showed that the variation in the assessments upon the stockholders of banks was responsible for the failure of one bank with a capital of \$100,000, the abandonment of business by two banks with capitals of \$600,000 each, the reduction of capital by six banks to the extent of \$3,950,000, and the establishment of one bank with a capital of \$100,000. There had also been a large reduction of surplus on the part of several banks by distribution or by losses in business, pointed out the report. In January, 1877, the Bank of Commerce sent proxy forms to stockholders for the purpose of obtaining authority to reduce the capital of \$10,000,000 to any amount not less than half of this unless some legislative change was made in regard to taxation. This consent was given and the legislation was not forthcoming.

The reduction of banking capital in New York City within a year amounted to almost \$10,000,000. The taxes on the shareholders in the New York City banks

²⁷ Governor Robinson's Message, 1877, Senate Documents, 1877, Vol. 1, No. 2.

in 1876 were nearly \$12,000,000 more than in 1875 while the tax on their real estate amounted to over \$10,000,000. Under such conditions it is no wonder that capital would be reduced and surplus distributed if this would bring relief. It was possible to put the surplus where it could not be so easily found by the assessors. Even under a reduced capital, if the profits remained as great as before, the value of the share should increase. If, then, the shares were taxed at their actual value, as was intended, a mere reduction of capital would have little effect upon tax. But the dividends and distributions of surplus were not always reflected in the value of the shares. Besides, there were wide discrepancies in the assessment and a reduction in capital often meant lower tax. It was hard for an assessor to assess a bank with a capital of \$50,000 as much as one with a capital of \$500,000. The nature of the banking business makes a large capital of no great importance. If large deposits can be secured and extensive credit given on a small capital and surplus, the profits still remain. There is a disadvantage, however, to the public in that the security of the bank is weakened.

In 1877 Mr. Elliott C. Cowdin championed a bill in the Assembly for the relief of the banks. In a speech on April 11, 1877, he presented many facts which vividly portrayed the alleged condition of the New York banks. People are mistaken, he said, when they think national banks are the pets of the federal government and should, therefore, bear heavy taxes imposed by the state and municipal governments. He quoted the federal comptroller as declaring the tax upon national bank capital relatively higher than upon any other capital in the country. Not only must it bear state taxation, but a national tax as well.²⁸ The average rate of taxation on the capital of all the national banks of the state was slightly less than three per cent. A comparison of a few cities follows:

²⁸ National Banks by the law of 1863 were required to pay three kinds of taxes to the federal government: (1) one per cent annually upon the average amount of notes in circulation; (2) one half of one per cent upon deposits; (3) they were required to keep a reserve of 25 per cent in city banks and 15 per cent in country banks. They could not use the reserve yet were taxed upon it.

New York, 3.1 per cent; Philadelphia, .5 per cent; Washington, .3 per cent. Including federal taxes the rate in New York City went to 5.1 per cent while in Albany and Syracuse it was more than 6.5 per cent. Money was being loaned on call at this period at about three per cent while notes were discounted at from four to six per cent. A study of the values of personal property on the assessment rolls in New York city shows the national banks to be almost forty per cent of the whole.

The speaker commented upon the difficulties of meeting the competition of foreign bankers who did not have to pay the tax, and upon the evils of reducing capital and surplus. The bill before the legislature sought to secure a more uniform taxation of banking capital as compared with other forms of capital. It met defeat, however, on April 26 by one vote. The opposition came chiefly from the rural districts. The *New York Times*²⁹ sought to excuse the rural legislator by saying the "he probably does not understand in the sense of realizing comprehension the severity and injustice of the present taxation; he is accustomed to the complaint of inequality, and expects as a matter of course, that every class and every interest will endeavor to escape being taxed."

Thus the system remained unchanged and the agitation against it continued. Comptrollers, state assessors, bank superintendents, and the press all condemned it. The assessors criticized the "vengeance" with which national banks were taxed, and expressed doubts as to whether any capital could bear such an enormous burden. The national banks were paying thirty per cent of all the taxes upon personal property.³⁰ The Superintendent of Banks, in his reports for 1878 and 1879³¹ was no less bitter. He emphasized that the banks were taxed upon what they had and upon what they did not have; upon what they owned and upon what they owed.

²⁹ Editorial, *New York Times*, April 23, 1877.

³⁰ Annual Report New York State Assessors, 1879. Senate Documents, 1879, Vol. 2, No. 28.

³¹ Annual Report Superintendent of Banks, Assembly Documents 1878, Vol. 1, No. 5; 1879, Vol. 1, No. 5.

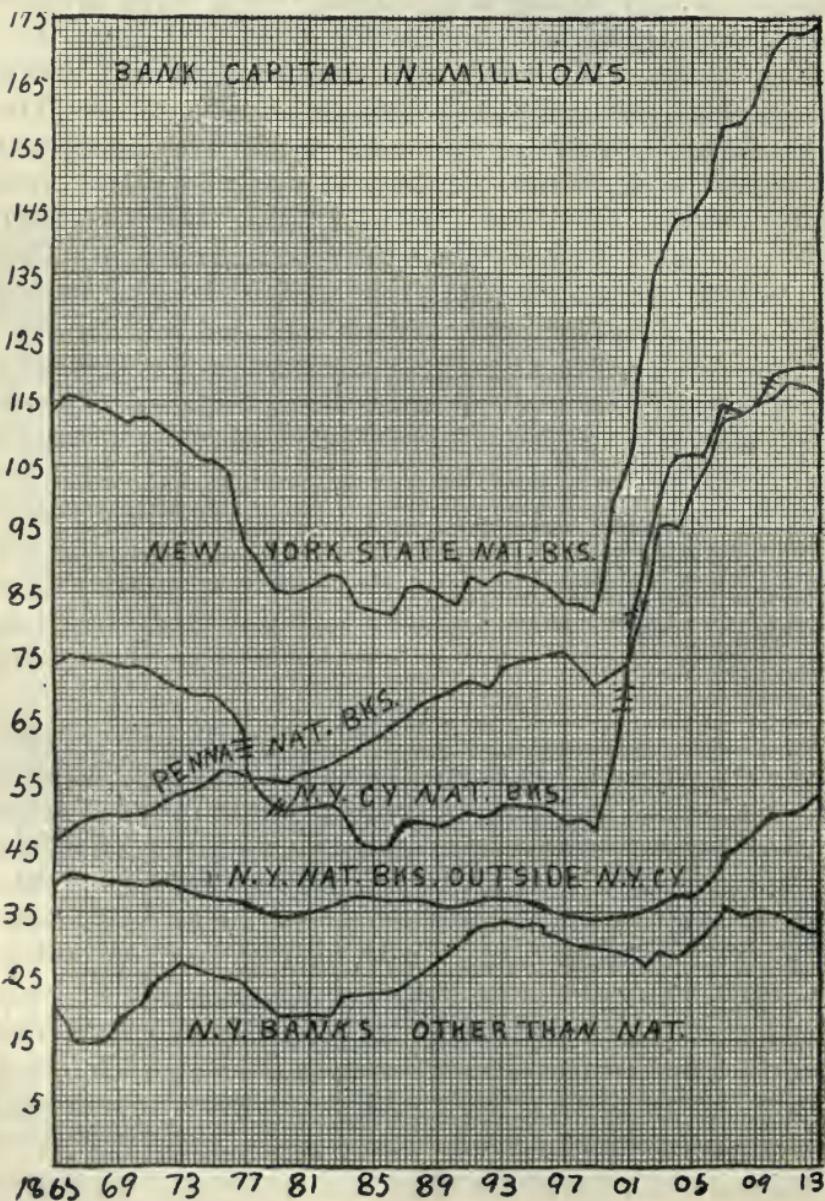
The tax was a war tax, he said, and it should not be continued. As an evidence of the difficulties which surrounded the banking business, he pointed to the number of banks which had either gone out of business, reduced capital, or suspended dividends. When an excessive tax is being placed upon bank shares it does not fall upon the richest and strongest capitalists, for a large proportion of bank shares are held by minors, estates, etc. When banks are excessively taxed, therefore, these classes must bear more than their share of taxation. The State Assessors showed that there were three companies within the state which, if taxed as national banks were taxed, would pay all of the state tax. Such taxation, however, would be considered an outrage upon the rights of property and relief would no doubt be given by the courts.³²

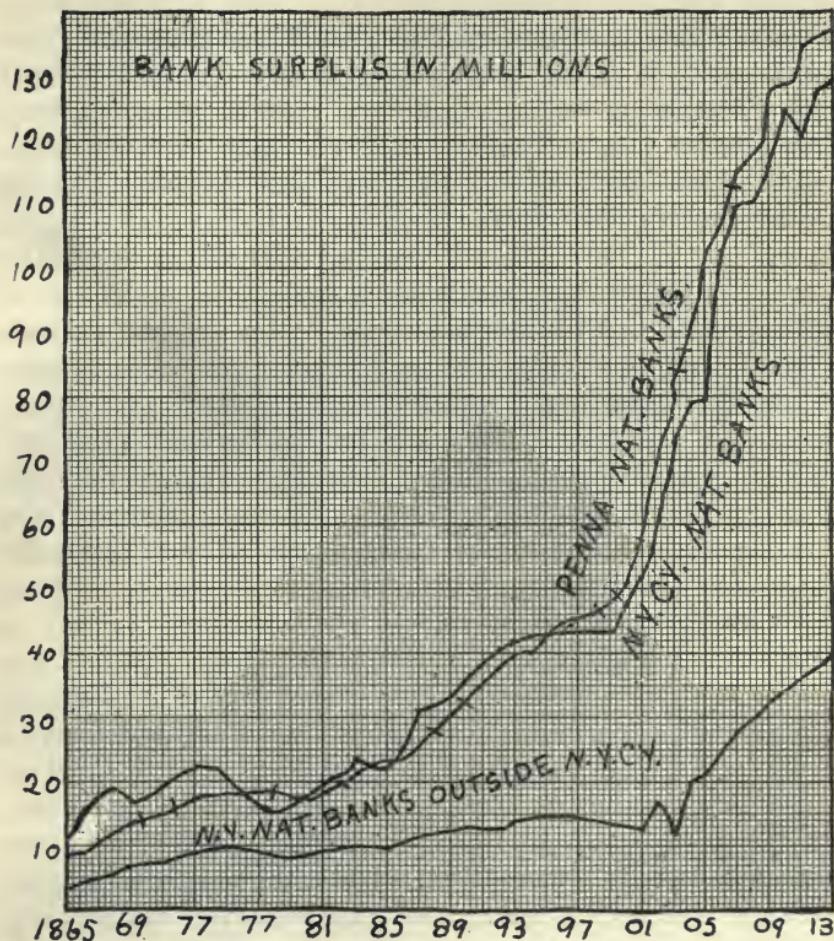
That all this dissatisfaction was not merely a clamor stirred up by the banking interests and that real hardships were imposed upon the banking business, seems clear. It had not been the practice of the state comptrollers, the state assessors or the bank superintendents unjustly to champion the cause of corporations. More frequently have they recommended measures which would bring more revenue to the state. But we find all these officers decrying the injustice to banks and the consequent evil effects upon business and industry.

Branches of foreign banks could flourish and prosper besides the struggling national banks. But as soon as a bill passed both branches of the legislature to tax foreign banking capital to the same extent that domestic banks were taxed, the representatives of the Canadian banks immediately held a conference and took measures to withdraw their capital. This would have taken some thirty or forty million dollars from the loan market and the commercial public became so aroused and exerted such an influence that the bill was vetoed. Even such a lesson as this did not awaken the legislators to the situation with respect to home capital. That the capital and surplus in-

³² Annual Report New York State Assessors, Senate Documents, 1880, Vol. 1, No. 26.

vested in the banking business in New York state, especially in New York city, actually decreased, and that this was not true of banking capital elsewhere is evident from a study of the Pennsylvania banks of the same period. The accompanying graphs make this clear. The capital of





the New York city national banks was nearly \$75,000,000 in 1865, while in 1885 it had fallen to \$45,000,000 and by 1899 had not reached \$50,000,000. The national banks of the whole state show a similar tendency. The amount of \$113,000,000 was invested in banking capital in 1865, about \$83,000,000 in 1885, and about the same in 1899. It is evident, too, that the heaviest burden was upon the banks of New York City, for the curve for the national banks outside of the city shows an almost constant amount of capital invested. That the national banks were hit much harder than the other banks is also clear for, with the exception of one period, there was not much of a decrease in the capital of other banks, but rather a

gradual rise. In Pennsylvania there was a gradual increase in national bank capital from \$47,000,000 in 1865 to \$62,000,000 in 1885 and \$70,000,000 in 1889. This latter amount was \$5,000,000 less than for the two previous years. The other set of graphs shows that although surplus was not reduced in similar proportion, yet there was a period in New York when it diminished. As a whole the amount of the surplus in the two states was about the same, although the percentage to capital was much less in New York than in Pennsylvania. We may therefore conclude that the banks were not unjustified in their contention that relief was needed.

In 1879 a ray of hope came to the banks. A stockholder in the National Albany Exchange Bank made application to have debts deducted. This was refused, the state courts upholding the assessment. He carried the case to the United States Supreme Court.³³ The court gave the opinion that the provision in the law that taxation on the shares of any national banking association should not be at a greater rate than that on other moneyed capital in the hands of individuals in the state, had reference to the entire process of assessment and included the valuation of the shares as well as the rate charged thereon. The statute of a state, therefore, which established a mode of assessment by which such shares were valued higher in proportion to their real value than moneyed capital, was in conflict with the law, even though no higher tax rate was levied on such valuation than on that of other moneyed capital. The statutes of New York, which permitted one to deduct his just debts from the valuation of all his personal property, except as much as consisted of bank shares, were therefore in conflict with the federal statute. The significant point in the decision is that it held that Congress had in mind the assessed valuation as well as the so-called rate of taxation. The state courts had held if the rate of taxation were uniform the law was not violated.

This decision did away with that part of the interpretation of the law of 1866 which prevented the deduction

³³ *People vs Weaver*, 100 U. S., 539.

of debts in the assessment of bank shares. In view of this it seemed that it would henceforth be impracticable to collect the tax as a whole at the source. The decision was hailed with delight by the banks. One of the New York City tax commissioners expressed the opinion that the tax paid by the New York City banks would be reduced by \$1,550,000, which would necessitate an increased tax on real estate.

The next revision of the state tax on banks was a direct consequence of this decision. The new statute,³⁴ enacted in 1880, was in general like the law of 1866, except that it contained the additional phrase, "but in the assessment each stockholder shall be allowed all the deductions and exemptions allowed by law in assessing the value of other taxable personal property owned by individual citizens of the state."

The relief given by this law, however, was less than had been expected. The law provided as before that state and national banks should be assessed and taxed in the same manner, but this did not provide improved assessment machinery, and so did not insure fair and equitable valuations. Even if there had been an exact uniformity in the assessment of state and national banks, there would not have been equality of burden, for the latter had also to pay taxes to the federal government. There was some agitation in 1880 to place a tax of one-half of one per cent on the average deposits in state banks and a bill intended to accomplish this was introduced into the legislature, but nothing came of it.

No doubt banking capital continued to bear a higher tax than other capital, because the assessors could easily place it upon the assessment rolls, while much of the other personal property could easily be hidden. Moreover, a difficulty was encountered in the assessment of shares where the bank was located. The banks sometimes refused to pay the tax, and so impracticable was it to collect taxes from non-residents, that in some places only resident share holders were assessed. In different dis-

³⁴ New York Statutes, 1880, Chap. 596.

tricts the shares continued to be assessed at from forty to one hundred and twenty per cent of par value.

The decision with regard to the deduction of debts encouraged the banks to bring a number of new cases before the courts. In the case of *McMahon vs Palmer* the court held³⁵ that the exemption from taxation by state law of some moneyed capital did not necessarily invalidate a statute authorizing an assessment upon national bank shares. The fact that some corporations and some personal property were subject to a lower rate of taxation than that levied upon banks would not in itself vitiate the law imposing taxes upon bank shares unless it appeared to be the clear legislative intent to effect thereby discrimination against them. Neither could a receiver bring action to have an assessment reduced since none but the share holders had any interest in the matter of taxation. Unless they appeared before the commissioners at the time specified in the law the action could not be subsequently reviewed by the courts.³⁶

Until this time the term "moneyed capital" in the hands of individuals," so frequently used by the statutes and courts, had been only partially defined. It remained for the United States Supreme Court³⁷ to do this in 1887, and its opinion was anything but favorable for the contentions of the bank. It held that the main purpose of Congress in fixing limits to the state taxation of the shares of national banks was to render it impossible for the state to create and foster an unfriendly competition by favoring institutions or individuals carrying on similar business or operations and investments of a like character. "Moneyed capital," then, embraced capital employed in national banks and capital employed by individuals when the object of their business was the making of profit by the use of their moneyed capital as money—as is in the opinion of the court, a characteristic of banking. It did not include, however, moneyed capital when in the hands of a corporation, even if its business be such as to make

³⁵ *McMahon vs Palmer*, 102 N. Y., 176; affirmed 133 U. S., 669.

³⁶ So held by the Court in *People vs Wall Street Bank*, 39 Hun, 525.

³⁷ *Mercantile Bank vs New York*, 121 U. S., 138.

its shares moneyed capital when in the hands of individuals or if it invested its capital in securities payable in money.

It further held that the mode of taxation adopted by the state of New York in reference to corporations, excluding trust companies and savings banks, did not operate in such a way as to tax the shares of national banks at a higher rate than that imposed upon other moneyed capital in the hands of individual citizens. Although trust companies created under the laws of New York were not banks in the commercial sense of the word, yet the court held that the shares of such companies were moneyed capital in the hands of individuals. Since, however, these companies were taxed upon the value of their capital stock, with deductions on account of the property in which their capital was invested, and were additionally taxed upon their income through the franchise tax, the court did not consider that the rate of taxation thus imposed was less than upon the shares in national banks. Deposits in savings banks, it held, were exempted from state taxation for just reasons, and as the exemption did not operate as an unfriendly discrimination against investments in national bank shares it could not affect the rule for the taxation of the latter.

Here we have set forth in no uncertain language the status of bank shares. Only such stocks of corporations and investments of capital as from the nature of the business engaged in, competed with national banks, were to be considered moneyed capital. Shares of trust companies were moneyed capital but there was no discrimination in the fact that no tax was placed upon such shares. We have noted that it was upon a similar point in regard to state banks that the law of 1865 had been declared unconstitutional. Capital invested in national bank stock was taxed upon its value less a deduction for real estate and for debts (where this last could be effected,) but with no deduction for amounts invested in United States securities. Capital in trust companies was taxed under the old law of 1857, and the basis was capital not invested in United States securities or other non-taxable property.

That some sort of discrimination still existed is evident, but the courts refused to recognize it as objectionable under the existing laws, so the only thing left to the banks was to move the legislature to action—an accomplishment which experience had proved to be no easy task.

For some time, however, the attempt to obtain relief went no further than remonstrances. In a report to the legislature in 1893,³⁸ Messrs. Charles A. Collin and J. Newton Fiero, counsel appointed to revise the tax laws, pointed out that banks were complaining with apparent justice that they were overtaxed as compared with other corporations. They attributed this to the relatively efficient machinery for bank taxation, and suggested a uniform method taxing all corporations. The *New York Financier*, in 1906,³⁹ told of the lack of uniformity in bank taxation and its results. A letter from President Perkins of the Bank of America to the stockholders, explaining a proposed reduction of capital, said: "The reduction is proposed because the bank is receiving very low rates of interest, while it is paying in taxes a sum approximating \$80,000, of which about \$30,000 can be saved when the reduction of capital is carried into effect." Had this bank been taxed in the same manner as trust companies the dividends could have been from one to two per cent higher.

The special tax commission of 1900 suggested a levy of one per cent upon the stock of national banks, state banks, and trust companies. The value of the shares was to be ascertained by adding together the capital stock, surplus and undivided profits and deducting the assessed value of the real estate which continued to be assessed locally. This, they thought, would eliminate the differences in the assessment of banking capital, and afford substantial justice to all.⁴⁰ The *Nation* in commenting upon this report said that it suggested "so just and equitable as well as so judicious and convenient a solution of

³⁸ Assembly Documents, 1893, Vol. 9, No. 54

³⁹ Quoted in *Public Opinion*, Dec. 31, 1896, Vol. 21.

⁴⁰ Report of Special Tax Commission, 1900, Senate Documents, 1900. Vol. 1, No. 7.

a perplexing problem that it ought to be accepted without contest by banks and trust companies alike."⁴¹ The recommendation, however, brought no results at this session of the legislature.

In 1901 Governor Odell in his message made practically the same recommendations.⁴² The legislature took up the question and at first attempted to enact a law placing a franchise tax of one per cent upon all banks and trust companies in addition to the taxes already borne. A general protest arose, not only from bankers but from other business men as well. This bill failed, but one was enacted⁴³ embodying substantially the suggestions of the governor and the special tax commission and which fixes the present basis of bank taxation. Every bank has to make a report to the assessors under penalty of \$100 plus \$10 for every day of delay. The assessment cannot be at a greater rate than upon other moneyed capital. The value of each share is to be fixed by adding together the amount of the capital stock, surplus and undivided profits, and dividing the result by the number of outstanding shares. The rate of the tax is one per cent upon the value so determined. Shareholders are entitled to no deduction from the taxable value of their shares because of their personal indebtedness or any other reason. This is in lieu of all other taxes for state, county or local purposes except the local tax upon real estate. On or before December 1 of each year the assessors have to determine the value of bank shares, and mail their findings to the bank officer, a certified copy being sent to the county treasurer. The bank collects the tax due upon its shares paying it to the county treasurer within fifteen days after it receives the statement of assessment and tax. A penalty of \$100 is attached for every day of delay in payment. In 1903 it was enacted that the value of a share for taxation of a bank in liquidation would be the actual assets divided by the number of outstanding shares.⁴⁴

⁴¹ *The Nation*, Feb. 1, 1900. Vol. 70.

⁴² Governor Odell, Message, Senate Documents, 1901, Vol. 1, No. 2.

⁴³ New York Statutes, 1901, Chap. 550.

⁴⁴ New York Statutes, 1903, Chap. 267.

Such is the accomplishment after thirty-five years of struggle and discussion. Since this system has been inaugurated we have had little complaint and this has been almost wholly from interests located without the state owning shares in New York banks. Under the old scheme they often escaped since the banks refused to pay the tax and the non-resident stockholders could not be reached by the officials. The court held that the statutes could not impose a personal liability upon a non-resident taxpayer, but could only make the property liable for the tax.⁴⁵ The court also decided that no deductions for real estate were to be allowed and that this did not invalidate the law.⁴⁶ Certainty, equality, and uniformity have in a large measure been secured for all institutions doing a banking business. The simple rule which is used in the determination of the tax does away with the use of any discretion on the part of the assessors, which is in itself a commendable thing. While some have pointed out that the tax on banking capital is lower than the tax upon other capital and have asked for an increase in the rate, and others have advocated a lower rate, the system as a whole has proved generally satisfactory. Few states have a system for which so much can be said in its favor.⁴⁷

Some objections have been made because the value of the real estate is not deducted when the assessment of capital is made. It is claimed that real estate is thus twice taxed. By carrying out the scheme as it is at present, however, the administration is simpler. Besides it is not

⁴⁵ *City of New York vs McLean*, 170 N. Y., 374.

⁴⁶ *Matter of the First National Bank of Ossining*, 182 N. Y., 460

⁴⁷ The special tax commission of 1907 thought the rate was too low. It was of the opinion that it should be increased to one and one-half per cent, and that the assessed value of the real estate should be deducted from the capital stock. It also recommended that one-third of the tax should go to the state. Mr. Thos. B. Paton, general counsel for the American Bankers' Association said before the National Tax Association at Buffalo, 1913, that "there are a few states in which the system of bank taxation is now satisfactory from the banking standpoint, and among these is the state of New York." The other states which he considers as having a satisfactory system are New Jersey, Washington, and Indiana, while that of Georgia, Minnesota, Iowa, and Illinois is only partially satisfactory.

"double taxation" that necessarily works injustice; it is rather the equity of the total tax burden that is important. So long, then, as the rate on the capital is low enough that it does not make the total tax excessive, no injustice is done by not deducting the value of the real estate.

The rate at which capital invested in banks should be taxed is a question which has been much discussed. Some have advocated a high tax while others would exempt it entirely. The one class looks upon banks as favored creatures of the government, while the other looks upon them as essential to business prosperity and seeks to establish them more extensively. While all sorts of productive capital might be more remunerative if untaxed, yet the state must have revenue and capital must bear a part of the burden. The nature of the business should of course be given some weight in determining the tax placed upon it. Some undesirable forms of enterprise we tax severely as a limiting or prohibitory measure. Such are the taxes upon the circulation of state bank notes, and the numerous taxes and licenses placed upon the liquor business. The earlier taxes placed upon New York banks, at least in the way in which they operated, seemed in their effect much like sumptuary taxes. If a corporate franchise confers some valuable privileges, such as monopoly, this may very often properly bear a higher tax than one which gives no special privilege.

The banking business is not, however, of such a nature as to suggest any clear reason why it should bear either especially high or especially low taxes. The granting of franchise to such institutions in no sense gives them a monopoly, or increases their earning power. In fact the use of the corporate form really increases the possibility of competition, for persons of small means can become shareholders. Moreover, banks render a necessary service and are essential to business operations. By furnishing credit when needed they help to develop productive business enterprise and thus enlarge the basis of taxation. If banks are unduly burdened banking facilities will be correspondingly lessened. It can at least be held, therefore, that banks should not be taxed so much as appreci-

ably to hinder capital from seeking that form of investment.

The taxation of bank deposits is another much discussed problem. Upon bank deposits is based the system by which goods are in a large measure exchanged. A tax that would seriously affect the amount of deposits, thus affecting this form of bank credit, would no doubt be a handicap to business transactions. Deposits, moreover, as shown by the books of a bank, are liabilities which in a large part merely offset loans or discounts on the other side of the account, and are only in small part balanced by cash. The real deposit in these cases is credit, and this is secured because there is some asset in the hand of the depositor which is presumably taxed under the property tax. The same is true of the actual cash deposits which, of course, are comparatively small in amount. They are liabilities of the bank and assets of the depositor. Under the present system they are presumably taxed to the depositor. No doubt much of the deposits escape the assessor, yet the same may be said for other classes of personal property. The suggestion, however, that cash deposits be taxed to the bank and the tax shifted to the depositor through a lower rate of interest is impracticable since it is impossible to differentiate this kind of deposits. The deposit system is not merely one of convenience, but one which in a special way, it is argued, redounds favorably to the bank. If liberal accommodation is to be obtained by the borrower he is expected to keep a correspondingly liberal deposit with the bank. This scheme of finance permits the bank to charge a higher rate of interest than what appears on the face of the transaction. Suppose a firm nominally borrows \$25,000 at seven per cent but that only \$20,000 are drawn out. In this case the rate of interest on the actual loan would be nearly nine per cent. By such transactions the profits of the bank are no doubt increased. On the other hand, however, the whole of the bank's resources are not productive. In order to carry on credit transactions a safe reserve must be kept and the minimum is often fixed by law. Their gains, therefore, from credit transactions are to

some extent counterbalanced by the losses on their reserve. Because then of the nature and ownership of the deposits, under the present system of taxation, there seems to be little justification for taxing them to the bank in addition to the property tax upon the owner.

TAXATION OF SAVINGS BANKS AND TRUST COMPANIES

The statuary and case law with respect to the taxation of savings banks has had an entirely different history. By the provisions of the law of 1857⁴⁸ the expenses of the banking department, incurred because of the supervision of savings banks, were to be borne by them in proportion to the amount of deposits held. In 1867⁴⁹ this was changed so that each paid five dollars, the residue of the expense being divided in proportion to deposits.

In 1866⁵⁰ the privileges and franchises granted by the legislature of the state to savings banks and other institutions for savings were declared to be personal property and liable to taxation. They were to be taxed in the town or ward where they were located to an amount not exceeding the gross sum of the surplus earned and in possession of the institutions. The officers were to be examined under oath by the assessors as to the amount of such surplus and the property was liable to seizure and sale for the payment of taxes assessed for privileges and franchises. A year later⁵² a law provided that the gross sum of surplus earned be diminished, for purposes of taxation, by the amount of the surplus invested in United States securities. The law of 1857⁵³ declared that deposits in savings banks were not taxable, except for the real estate and stocks, which were owned by the bank. In 1896⁵⁴ the "deposits in any bank for savings which were due to the depositors," were declared exempt from taxation. In

⁴⁸ New York Statutes, 1857, Chap. 136.

⁴⁹ New York Statutes, 1867, Chap. 136.

⁵⁰ New York Statutes, 1866, Chap. 761.

⁵² New York Statutes, 1867, Chap. 861.

⁵³ New York Statutes, 1857, Chap. 456.

⁵⁴ New York Statutes, 1896, Chap. 117.

1901 an extra tax of one per cent on the par value of their surplus and undivided earnings was assessed,⁵⁵ and in 1914 every savings and loan association was classed as an institution for savings, and neither they nor their property was to be assessed under any law that exempted savings banks.⁵⁶

The amendment of 1867 with regard to deductions of surplus was evidently not due to judicial action. In the same year a case involving the deduction of the amount invested in United States securities came before the court.⁵⁷ The decision was, that where a tax is declared upon franchises and privileges, it is not to be deemed illegal because a corporation employs the bonds of the United States as one of the means of accomplishing its purposes. The tax was upon the franchise, and it was unimportant what use the corporation made of it. Moreover, the state granted the franchise and could annex any conditions to its enjoyment which it chose.

The court also laid down a rule for valuing the surplus for the purpose of fixing the franchise tax. The Comptroller must appraise the securities in which the surplus is invested at market value when this is below par, and must never appraise it above par even though the market value may be above par.⁵⁸ The court also decided that when a savings bank was being assessed upon shares of other banks which it owned, both its debts and the amount invested in United States securities should be deducted.⁵⁹

Although some difficulty has arisen in determining the value of the surplus, the question which has overshadowed all others in point of importance is whether deposits in savings banks should be subject to any tax. In the earlier period total exemption was pretty generally advocated.

⁵⁵ New York Statutes, 1901, Chap. 117.

⁵⁶ New York Statutes, 1914, Chap. 369.

⁵⁷ *Monroe County Savings Bank vs City of Rochester*, 37 N. Y., 365.

⁵⁸ *Bank for Savings vs Miller*, 177 N. Y., 461. This rule is practically the same as laid down in the statute (1892, Chap. 689) for determining the amount of surplus which a bank had. Its surplus could not exceed 15 per cent of its deposits.

⁵⁹ *Bridgeport Savings Bank vs Barker*, 154 N. Y., 128.

More recently, however, an increasing number of writers on taxation are in favor of some form of taxation. The position of deposits in savings banks differs from that of deposits in commercial banks. Savings banks were established for the small depositor—for the one whose savings are small, and the kind of business done by the bank is limited in many ways.

While the importance of savings banks accounts is diminishing,⁶⁰ and the average per depositor is small, the total may aggregate many millions of dollars. Attempts to tax deposits have been met with the objection that this is to tax the poor and industrious, the widows and orphans. While the average deposit is small, yet quite a large number of wealthy men use the savings banks. The maximum individual deposit is \$3000, but this has been evaded by the depositor using different banks or making his deposits under different names. The special commission in 1907⁶¹ called attention to a case where, in administering an estate in one of the interior counties, the court found deposits in every savings bank in the state between and including Buffalo and Albany. In another case an estate was appraised for the inheritance tax, and every cent of the \$65,000 was found in savings banks. It further pointed out the large number of cases where deposits have been made under different modifications of the same name and under the names of different members of the same family. By these methods, then, the purpose of the law, in fostering savings among the laboring classes and the poor, has been abused. For this reason the taxation of savings accounts has been advocated.

The commission to which we have just referred thought it best to make the maximum amount exempted from tax \$1000. This might result, it thought, in limiting the deposits in any one bank by any one person to \$1000 and hence virtually exempt all deposits from taxation. Governor Dix, in his message of 1912, pointed out

⁶⁰ The decline in savings deposits can probably be accounted for by the spread of investment intelligence among individuals together with the increased ease of securing suitable securities.

⁶¹ Senate Documents, 1907, Vol. 5, No. 11.

the violation of the spirit of the law whereby millions of dollars sought the savings banks as an investment; and asked for some method of reaching this class of capital which would not burden the small depositor.

It does not seem that fixing \$1000 as a maximum tax-exempt deposit would accomplish the desired end. If persons use a number of banks and a number of different names under which to make deposits when the exemption is \$3000 there is no reason to suppose that the practice would be stopped with a \$1000 maximum even though it might be somewhat lessened. One would have to patronize a few more banks or use a few more names, with evasion continuing much as before.

We would not penalize small savings, but it is doubtful whether a moderate tax upon deposits would have this effect. Even if it should mean a lower rate of interest, it would work little hardship, since the tax would only amount to one or two dollars and this would be the only tax that many of the depositors would pay. The opposition to such a tax has probably not come in large measure from the small depositor, but has been invoked in his name by those who have used the banks for larger investment. The man whose motive is saving would not often be induced to give it up because of a small tax. Because, then, of the amount of deposits in the savings banks (\$1,660,564,190.73 in 1912), the negligible burden upon the small depositor and the development of the investment feature, there can be little reason for opposing a small tax upon savings bank deposits.

Trust companies have also been treated differently from other banks. In 1874⁶² they were placed under the banking department, and were to be assessed their proper proportion of the expense of the department. By the law of 1901⁶³ every trust company organized or authorized to do a trust business under general or special laws of the state was to pay an annual tax for state purposes. This tax is for the privilege of exercising its corporate franchise or carrying on its business in an organized capacity.

⁶² New York Statutes, 1874. Chap. 324.

⁶³ New York Statutes, 1901, Chap. 132.

The tax is one per cent on capital stock, surplus and undivided profits. This is in lieu of all other taxes, except the organization tax and the owners of the shares are not taxed upon them. Other banks are taxed in the same way, but in the case of trust companies, there are no federal statutes to make confusion. Before this law was enacted trust companies were lightly taxed and banks complained of the discrimination. Since they have been put on the same basis the banks are satisfied, and there has been very little complaint from the trust companies. As they are in direct competition with banks in many ways it is but just that they should be taxed in the same manner.

CHAPTER VII

TAXATION OF RAILROADS AND OTHER PUBLIC SERVICE CORPORATIONS

Public service corporations furnish one of the most complex problems of taxation. This is due to different causes. The legislature at an early date divided public utilities into classes each of which was taxed differently. This system still continues. The problem has been further complicated by Federal laws, and in the apportioning of state and local revenues.

For many years the basis of public utility taxation was the general tax law. Concessions, we have pointed out, in the form of commutations and exemptions were made to turnpike companies and bridge companies.¹ Leniency was also shown to gas companies. In 1848 the state gave municipal authorities power to exempt any such company from taxation of personal property for a period not to exceed three years from its organization.² Not only was leniency shown to individuals and companies undertaking public utility enterprises, but the state itself undertook many projects. State activity was especially marked in building canals.³ These canals were a source of revenue, and railroad competition was at first looked upon with disfavor. A law enacted in 1848 stated that any road paralleling or nearly paralleling any canal of the state, and within thirty miles of it, would be considered as diverting freight business from the canals. Because of this the same state tolls that would have been paid had the property been transported by canal were to be paid by the

¹ Chapter I, p. 13.

² New York Statutes, 1848, Chap. 37.

³ Don Sowers, *Financial History of New York State* (New York 1914) gives a good account of the expenditure of public funds.

railroad.⁴ After 1851, however, railroads were relieved from the duty of paying tolls.⁵

The attempt to assess railroads under the general tax law soon led to litigation. The Mohawk and Hudson Railroad Company, in 1834, resented the attempt to tax all its capital as personal estate. In court the chancellor gave the opinion that a railroad was not to be assessed, as personal estate, upon the part of its capital invested in lands. In the same category with land he placed the rails and other fixtures of the system. Such property, he held, was to be taxed as real estate at its actual value, while capital stock not so invested was to be taxed as personal property at the location of the principal office.⁶ This decision proved but a stepping stone to further difficulties. Real estate, it held, was to be assessed at *actual value* but it soon became apparent that *actual value* was a very indefinite term. Was the real estate to be considered as isolated and assessed on the same basis as other property in the district, or was it to be taken as a part of the unified system? In assessing one road the assessors estimated the value of the entire road, taking into consideration not only the physical property but earnings as well. The value for the district was then determined by taking such proportion of this entire valuation as the length of road in the district bore to the entire length. The value for the district, by this method, amounted to about \$250,000, whereas the value of the local property, taken by itself, was found to be about \$60,000. The Supreme Court upheld the company in their refusal to accept the assessment. The real estate of a railroad company, it held, could not be viewed as a part of a unified system, but must be assessed in each district as the actual value of that part found within the district. No account

⁴ New York Statutes, 1848, Chap. 140. This law followed others of a similar nature which affected only particular companies. The same provision was incorporated in the act of 1850 which governed railroad incorporation. Heavy penalties were attached for refusal to pay tolls.

⁵ New York Statutes, 1851, Chap. 497.

⁶ *Mohawk and Hudson River Railroad Company vs Chute*, 4 Paige 384.

was to be taken of income or general profitableness. The method of appraisal was to be the same as that used for assessing adjacent lands owned by individuals.⁷

This decision, given in 1851, was followed in 1853 by the Comptroller's recommendations relating to railroad property. He held that a railroad was nothing more nor less than a farm, cultivated and used for its particular objects instead of raising grain and rearing stock. It was real estate to be assessed simply as such.⁸ The Comptroller, in his report for the preceding year, had advanced the opinion that neither capital stock nor actual cost would be a measure of value. Neither did he consider the district assessors capable of ascertaining the value of railroad property. He suggested that such assessment might be better made by county or even state officials, and the value distributed to local districts in proportion to road mileage.⁹

The questions upon which this litigation was based were soon settled by statute. In 1857 a law was enacted¹⁰ which removed railroads from the scope of the general tax system, and which formulated a scheme for taxing such corporations as a separate class. The real estate of railroads was to be assessed locally in the same manner as the real estate of individuals. Personal property was to be assessed by the assessors in the district where the principal office was located, but the proceeds of this tax were to be paid by the companies to the collectors of the several localities through which the road passed. The payment was to be in proportion to mileage. For the purpose of arriving at the assessment, every railroad company was required to make an annual report to the assessors of each district in which they owned property. The report was to specify the land owned by the company,¹¹ the length, cost, present value and percentage

⁷ *Albany and Schenectady Railroad vs Osborn*, 12 Brbour, 223.

⁸ Annual Report of New York State Comptroller, Assembly Documents 1853, Vol. 1, N 1. 5.

⁹ Annual Report of New York State Comptroller, Assembly Documents 1852, Vol. 1, No. 10.

¹⁰ New York Statutes, 1857, Chap. 536.

¹¹ In giving the amount of land the companies were to deduct the

depreciation of the superstructure, and the value of buildings belonging to the company. Such a list was to be taken as *prima facie* evidence of value unless fraud were suspected by the assessors. Whenever the correctness of the report was questioned evidence could be taken under oath as to its completeness and the valuation of the property listed therein. In no case could the valuation be made less than that found in the report of the company.

This was the first attempt by the legislature to solve the valuation problem. The method was self-assessment with revision by the assessors. The procedure was merely an attempt to administer the general property tax. That the system was defective is evident because there was no adequate supervision of the assessment, and no assurance that the reports made by the companies were accurate. It was, however, enough of a departure from ordinary methods to be viewed with misgivings by state officials.¹² The administrative features were somewhat modified in 1870, but not so as to affect its general nature.¹³

In practice the assessment of railroad property was left pretty much to the local assessor and gross inequal-

areas used in crossing highways. If the report was more than thirty days late a penalty of two hundred and fifty dollars was attached. This was to be collected by the assessors and used for the benefit of the poor.

¹² The Comptroller, in his report for 1858, (Assembly Documents, Vol. 1, No. 5) attacks the law as being unjust. He criticizes the attempt to get valuations from company reports and asks that the law be revised so as to assess railroad property in the same manner as other property. The law was not, however, strictly applied in all cases. Exemptions from taxation were sometimes granted for specific reasons. For example, in 1866 (Chap. 546) the Poughkeepsie and Eastern Railroad was exempted from the taxes upon real estate, personal property and capital stock until a single track had been completed. The period of exemption, however, was not to exceed ten years.

¹³ New York Statutes. 1870, Chap. 506. Provision was made by which the tax could be paid to the county treasurer. If this were done a fee of one per cent of the tax was attached. If the tax were not paid within thirty days the district collectors proceeded to collect the tax together with a five per cent fee. The taxes paid to the county treasurer were credited to the districts by which they were assessed. Should this amount to more than what would naturally be paid to the county by the district the difference would be paid by the county to the district.

ties resulted. The Special Tax Commission,¹⁴ in their report made in 1871, describe the working of the system as follows:

The System of taxing railroads in the state of New York is as imperfect and objectionable as it well can be. The road beds and the real estate of the companies are valued and assessed in the different towns through which the line of the road extends, according to no uniform standard, but at the discretion or rather caprice, of the local assessors, from whose decisions there is practically no appeal. In some towns the standard of valuation of the property is reported to depend on the amount annually required to defray the highway expenditures; and in another instance the erection of an expensive bridge over a navigable stream was regarded by one of the towns, on whose territory the bridge abuts, as a sufficient warrant for the erection of a new school house. In one town, where a company had substituted an expensive station house for a dilapidated one to the great benefit of the town, the erection of the building was immediately made the occasion of a large increase in the taxation to which the company was subjected. The effect of this was that the company concluded not to repeat the building of any more expensive station houses along their line, but would get along with cheapest buildings possible; or in other words the action of one town in respect to taxation, was made to result in detriment to all other towns on the line of the road, whose need for improved station houses might be equally or more imperative. On the other hand it is alleged that the railroad companies often endeavor to protect themselves from what they call injustice, by threat of retaliatory measures or by actually executing such as in the above case. And that after all, the companies do not pay in the aggregate in the way of *direct* taxes as much as would be equivalent to the average rate imposed throughout the state on similar corporate property such as banks, gas and manufacturing companies; rolling stock, in their valuations being classed as real estate, while the funded and floating debt is made to offset and neutralize as indebtedness all valuations and assessments against the company for personal property. During the year 1869 the aggregate tax paid by steam railroads on real estate, according to the State engineer, amounted to \$1,565,670.52. . . . If the same property had paid the average rate of taxation throughout the entire state for that year (2.48 cents on the dollar) the aggregate would have amounted to \$6,859,467.75. . . . In New York the real estate of railroads as well as the road bed is assessed in the different towns through which the road runs. The Supreme Court of Massachusetts which has had the question before it in at least three different forms, has uniformly decided that land taken or purchased by railroad companies for their tracks, not exceeding five rods in width, is taken in the exercise of the right of eminent domain and is therefore not liable to local taxation. The court held that local taxation of a road bed was illegal because the road was a public work, es-

¹⁴ Report of Special Tax Commission 1871, Assembly Documents, 1871, Vol. 3, No. 39.

tablished by public authority, intended for public use and benefit, the use of which is secured to the whole community, and constitutes therefore, like a canal, turnpike or highway, a public easement.

After quoting the Massachusetts decision at length, the members of the Commission expressed the opinion that it would be better for New York to adopt the Massachusetts system thus putting the taxation of railroad companies exclusively under state control. They recommended that the comptroller or some other state officer be authorized to assess the corporate franchise at a valuation equal to the aggregate market value of its capital stock, and funded and floating debt, less the cash on hand. Railroads should be taxed on this value at a fixed rate and should be exempt from all other taxes. The tax could either be paid and used locally, or be paid to the state and used for state purposes. Since franchises, however, were granted in the name of all the people, and since each district through which a railroad runs had special benefits from the railroad in the increase of the value of its local property and of the trade and convenience of its citizens, the commission preferred that the tax be used for state purposes. The commission expressed the opinion, also, that one of the avowed objects of those who had framed the tax laws [relating to railroad property] was to get as much of confusion, inconsistency, and irregularity in the subject matter as the circumstances would render possible.¹⁵

These recommendations of the special commission met no better fate than did previous recommendations for reform. Inequalities continued in the assessment not only of railroads but also of telegraph companies, gas companies, etc., as well. Telegraph companies were assessed only on their personal property. The largest company in the state had its principal office in the state and was assessed at only \$200,000, while another large corporation was assessed at \$1000.¹⁶ The assessment of the railroad property became increasingly unfair; in some parts of the state it was assessed higher than other real estate while in

¹⁵ Page 183 of report.

¹⁶ Annual Report of State Assessors, 1874, Senate Documents, 1874, Vol. 2, No. 23.

other parts it practically escaped taxation. The rolling stock and other personal property was seldom assessed. One reason for this was the difficulty in determining the principal office. Instances arose where the assessors were told in one city that the principal office was in another city while the tax officials there were informed that it was in the first city. The state assessors thought that no such amount of real estate devoted to other uses went untaxed, whether mortgaged or not.¹⁷ The press was equally critical, and pointed out, that despite some cases of real injustice to the railroads, the rate of tax paid on the capital invested was very low. The *New York Times*, for example, held that the state was entitled to exact from railroads and other great corporations some fiscal equivalent for the charter privileges given them by the state. The taxes then paid by such corporations, it was pointed out, bore no adequate proportion to the capital invested in the undertakings nor to the large returns secured by the proprietors. This capital, represented by the capital stock, bonds and floating debt, practically escaped taxation, while its enormous earnings contributed nothing to the state. The receipts from the real estate were a bagatelle in comparison with capital or earnings, and yet the real estate as assessed by the district officials was practically the entire basis of taxation. It suggested a tax upon railroads on the basis of stock, bonds, and floating debt, which, it held, might be taken to represent the property of the railroad. Such a basis of assessment would simplify matters, and eliminate the necessity for troublesome investigation. Since, however, these three items represent the aggregate of property to be assessed, it would abandon the separate assessment of real estate for state purposes. The road bed, moreover, should not be assessed piecemeal by local authorities since it cannot be properly taxed except as a part of the grand aggregate. Neither could land taken for a right of way be treated as ordinary real estate for in reality it was but held in trust for the public, since the right under which

¹⁷ Annual Report of State Assessors, 1877. Senate Documents, 1877, Vol. 2, No. 26.

it was acquired and used was in certain contingencies revocable. To treat it as real estate was to assume the companies to be absolute owners.¹⁸ That such opinions did not weigh heavily with the legislature is shown by the fact that by a statute of 1878 pipe line companies were to be assessed and taxed in the same manner as railroads.¹⁹

The lack of definiteness in the law continued to cause much litigation. The rule for the proper valuation of railroad real estate as laid down in *Albany and Schenectady Railroad vs Osborn*²⁰ proved to be unsatisfactory and later court decisions on this point show an important change of opinion. In 1866 the Supreme Court held that the real estate of railroad companies should be assessed at its actual value for the purpose to which it had been adapted and not as mere farming land. In estimating this value the assessors were not bound to consider it merely as land and superstructures, isolated from other parts of the estate which contributed to make up a complete and safe railroad system.²¹ The Court of Appeals, held, in 1871, that the value of each piece of property was to be estimated in connection with its position, its incidents, and the business and profits to be derived therefrom.²²

The first important change in the statutory system of taxing transportation companies came in 1880. The tax on land and real estate remained as before, but a tax was imposed on gross earnings in lieu of the tax on capital and personal property. This was a state tax, to be paid semi-annually, of five tenths of one per cent of the gross earnings from business transacted in the state. Compan-

¹⁸ *New York Times*, Editorial, April 5, 1879. An editorial for April 8, 1879 pointed out that in the assessment of capital, the distinction between nominal and actual values must be regarded, at least so far as the stock was concerned. With one or two well-defined legislative rules applicable to the assessment, it suggested there would be no serious difficulty.

¹⁹ New York Statutes, 1878, Chap. 203.

²⁰ Above, page 124.

²¹ *People vs Fredricks*, 48 Barbour, 173.

²² *Buffalo State Line Railroad vs Assessors*, 48, N. Y., 70.

ies were required to render a sworn report of their gross earnings under a penalty of a ten per cent increase in the tax.²³ In 1881 the tax was specially made a tax upon the corporate franchise or business in the state.²⁴ By a law of 1906 a railroad company whose property was leased to another company must pay a tax of three per cent on all dividends in excess of four per cent.²⁵

The laws taxing railroads, with some modifications, were applied to other public utility companies. The property of telegraph companies was to be assessed in the districts where located from statements made by the companies.²⁶

The assessment and collection of taxes on this form of property was to be administered in the same way as taxes on other real estate were assessed and collected. In 1896 all companies engaged in furnishing water or gas²⁷ for heating, lighting and power purposes, in addition to the semi-annual five-tenths of one per cent franchise tax upon gross earnings, were required to pay a three per cent tax on dividends declared above four per cent on the actual capital employed. Reports were required showing capital, earnings and dividends. Elevated roads and surface roads not operated by steam were to pay an annual franchise tax of one per cent of gross earnings within the state, and three per cent of the dividends declared in excess of four per cent on the capital employed.²⁸

²³ New York Statutes, 1880, Chap. 542. As stated in the act it applied to every corporation, association or joint stock company, whether domestic or foreign, formed for transportation purposes; to telegraph, telephone, palace and sleeping car companies. It did not, however, apply to street railways.

²⁴ New York Statutes 1881, Chap. 361.

²⁵ New York Statutes, 1906, Chap. 477.

²⁶ New York Statutes, 1881, Chap. 591. The telegraph companies were required to furnish an annual report to the state comptroller and to the treasurer of each county where they had property. From the county treasurer the district officials were to get copies of the report from which to make assessments. A law of 1886 (Chap. 659) defined "lines" as including interest in lands on which poles stand, right to erect poles, and the poles, wires, arms, insulators, etc., used as a part of the line. It further gave the tax collectors the right to sell a part of the line for unpaid taxes and to convey it to the purchaser.

²⁷ Possibly a comma is omitted after *gas*. See note on page 135.

²⁸ New York Statutes, 1896, Chap. 908.

These statutes, with slight modifications, remain in force and represent the present law for the taxation of public service corporations. All are subject to the annual franchise tax except elevated railways and surface roads not operated by steam, and water, heat, light, and power companies. The exempted railways must pay an annual tax of one per cent of the gross earnings within the state besides a tax of three per cent on dividends in excess of four per cent on the actual amount of capital invested. The water, light, and power companies must pay an annual tax of five tenths of one per cent of gross earnings and the three per cent tax on dividends in excess of four per cent on capital invested. In addition to the annual franchise tax all transportation and transmission companies must pay the "additional franchise tax." This amounts to five tenths of one per cent of the gross earnings. All are subject to the organization tax and the stock transfer tax.²⁹ These taxes which are all for state purposes are in lieu of all other taxes for state purposes upon personal property. The companies are, however, assessed and taxed locally—the real estate at situs, and the capital stock at the place of the principal office. Since the state levies a small direct tax, a part of the local tax on corporations goes for state purposes. It would seem that only that tax assessed on real estate could be so used.

There has been a great deal of litigation since these new taxes have been inaugurated, but this has been due only in small measure to the state taxes. The large majority of cases have arisen from the continued attempt to apply the general property tax to railroad and telegraph companies. In the case of the state tax it has sometimes been necessary for the courts to determine just what the gross earnings were or what were derived from business "originating and terminating within the state." The Court of Appeals held, for instance, that money received for carrying the mails was not taxable where it was im-

²⁹ See Chapter II page 31 for a discussion of the Organization Tax, and Chapter III page 52 for the Stock Transfer Tax. In addition to these taxes there is the Special Franchise Tax which is discussed in the next chapter.

possible to ascertain the proportion of the mail traffic which originated and terminated within the state.³⁰

The questions as to the proper valuation of real estate is responsible for most of the cases relating to local taxation. The courts have alternated between earnings and the cost of reproduction as the proper basis of valuation. Most of the decisions in the 70's and 80's attributed an important place to earnings. The Court of Appeals, for example, in 1871 held that the assessors were justified in taking into consideration the earning power of the road considered as a whole. This was because, it held, "a railroad through the town only, having no connection at either end, would be of no value. The erections and superstructure would destroy its value for farming purposes. As a railroad it would have no passengers and no business and would be worthless. The attempt to use it as such would involve debt and embarrassment but no profit. . . . Each piece of property is to be estimated in connection with its position, and the business and profit to be derived therefrom. The road in question is part of a whole and is to be valued as such. This is independent of the taxation of the capital. It is the estimate of the value of the real estate for railroad purposes as a mill is to be estimated for its value for milling purposes and not as its value for a church or banking house."³¹

In 1882 the Supreme Court held that a railroad should not be valued for taxation as a long narrow strip of land used for farming or for any other purpose except as the bed of a railroad. Nor should the part of a railroad in a particular town be estimated by the cost of any expensive rock cut, or quicksand filled, or a terminal located in that town. It should be valued as a part of a whole and the consideration of profits should have a large, if not controlling, influence upon the value.³²

³⁰ *Morgan vs New York Central and Hudson River Railroad*, 168 N. Y., 1.

³¹ *Buffalo and State Line Railroad Company vs Assessors*, 48 N. Y., 70.

³² *O. & L. C. Railroad Company vs Pond*, 13 Abbott's New Cases, 1. In the cases of *Albany and Greenbush Bridge Company vs. Weaver*, (34 Hun, 321) and *Powers vs Kalbfleish*, (25 Appellate Division, 432) practically the same attitude was taken.

In 1897, however, the Court of Appeals held the reproduction cost to be the proper basis for valuation. The Delaware, Lackawanna and Western Railroad Company had been assessed on seven and one half miles of road, the cost, rentals, and earnings being taken into consideration. This assessment was admitted to be higher than the cost of reproduction. The court pointed out the difficulty of formulating, from the adjudged cases, any general rule applicable in all cases to the valuation of the real estate of a railroad company for the purpose of taxation. The cost of reproduction, said the court, seems to be the just and reasonable rule of valuation, and it could conceive of no reason for assessing the property at a greater sum than this. Whether it was really worth what it would cost to reproduce it would depend upon the earning capacity of the road after it was built. After a road had been valued at what it would cost to procure the land, construct the road bed, put down the ties and rails, and erect the buildings all new, it was difficult to see any ground for assessing it at a larger sum. The value of a railroad for taxation might be much less than the actual cost of producing the property in the condition in which it was found by the assessors, but it could never exceed it. Any method of assessment was erroneous which included the privileges and franchises of a company in the valuation of its real estate.³³

In commenting on this decision the New York Public Service Commission for the Second District pointed out that the real ground of the decision was not that the cost of reproduction was necessarily a true basis of value, but the only practical and practicable one. They interpreted the reasoning of the court somewhat as follows: The assessors were to assess the real estate and when they began to try to determine how much was earned from intangibles and franchises, erroneous decisions would nec-

³³ *Delaware, Lackawanna & Western Railroad Company vs Clapp*, 152 N. Y., 39. In 1908 the same court held (*O. & W. Railroad Company vs Shaw*, 202 N. Y., 556) that reproduction cost was the maximum valuation, for tax purposes, to put upon the part of a continuous railroad situated within a given tax district. If the road were not a paying one the valuation might even be less.

essarily result. Such determinations were too great for the capacity of the average assessor; that assessors had better be confined to the simple, definite assessment of real estate, easily applied and which would result in practical justice. The court, pointed out the commission, adopted the cost of reproduction with all its known absurdities and inconsistencies. In one town five miles of track may have been constructed with little expense while in an adjoining one cuts and fills may have been expensive. One portion would be as great value to the operation of the road as another. If there was any theory upon which such discrepant theories could be justified it was cost of reproduction; yet it was doubtful whether the end was accomplished by that sort of assessment.³⁴

The decision, however, is more logical than this interpretation would indicate. If the property, track, buildings, road bed, etc., were to be assessed piece-meal and disjointedly, then the reproduction cost would represent the maximum value any particular portion could have. Very often the value might be less than this. It is only in assessing the company as a whole that the earning capacity can be considered since this is an attribute of the whole plant and not of any small isolated part.

In 1908 the Appellate Division of the Supreme Court prescribed a method for the valuation of the property of a water company. This differs from the methods just described in that it took earnings as the basis for the assessment. It held that where a water company owned tangible property outside the street, and both tangible and intangible property in the street,³⁵ each of these three classes should be considered as contributing pro rata to the net earnings according to its respective value. Actual value and not cost was the true basis of taxation, hence the value of the intangible property—the mere right to lay water mains—must be determined by treating it as a part of the plant and basing its value upon capitalized net earnings. Intangible property had a value if it was earn-

³⁴ Report of New York Public Service Commission, Second District, 1913, Vol. III, p. 306.

³⁵ By tangible property in the street the court meant the fixtures, etc. while the intangible property was the right to use the street.

ing an income and if, even with good management, there was no adequate return, it had correspondingly little value. The value of the property of a water company for the purpose of taxation, especially the value of its franchise and good will, could not be ascertained until the franchise tax,³⁶ all other taxes and a proper up-keep fund have been deducted from current earnings. The earnings and expenses for one year alone should not be considered, but the average earnings and expenses for a series of years or for such time as is reasonably available. The method prescribed for finding the value of intangible property was as follows: from earnings deduct salaries and other expenses of maintenance, all taxes including approximate amount of the special franchise tax and such earnings as would be proper for all up-keep not ordinarily covered by maintenance account; the balance was to be treated as the actual net earnings. From this six per cent of the value of real estate and other tangible property was to be deducted as a fair return on investment. The earnings which remained, capitalized at six per cent, would represent the fair value of the intangible property.³⁷

Here a definite rule for the valuation of a public utility company for taxation is given with capitalized net earnings as the fundamental basis. Yet this rule proved no more satisfactory than former ones and many assessors continued to use their own guess work in valuation. The reasoning of the Public Service Commission which we have noted above, and the complexity of the system proposed easily explain why it is not generally used. Many assessors do not have the time or inclination to use such schemes as the courts may dictate while many others do not possess the ability to use them even if they had the desire.

³⁶This undoubtedly has reference to the special franchise tax which is discussed in the next chapter. Section 186 of the tax law exempts companies formed for supplying water or gas, or for electric or steam heating from the annual franchise tax. A literal interpretation of Section 183 of the same law would subject general water companies to the annual franchise tax. Under the list of exemptions it states that companies formed for supplying water or gas for electric or steam heating shall be exempt.

³⁷*Jamaica Water Supply Company vs Tax Commissioners*, 128 Supreme Court, Appellate Division, 13.

The present system of taxation, though somewhat complicated because of the elaborate classifications of public utilities, did get rid of some of the old difficulties. With the adoption of uniform accounting, corporation reports are becoming more trustworthy and a part of the taxes are easily computed. The gross earnings tax for state purposes has secured a greater equality than when the tax was levied by the local assessors, and is of course a real advance. A large amount of inequality has been found in telegraph valuations since these companies have practically been made their own assessors. The estimated cost of lines as returned by the various companies has shown great disparities. Although some valuations were extremely low, yet there was no official review and power to question their correctness was nowhere specifically given. But the system has worked smoothly enough so that there have been few complaints from either state officials or the corporations, and consequently the courts have had little to do.

This has not been true with assessment and taxation for local purposes. Complaints of inequality continue, and litigation increases. This last is initiated largely by the railroad companies who claim that their property is assessed at much higher figures than is other real property in the same districts. Many other states are far in advance of New York in seeking to remedy these evils. They have recognized the impossibility of securing equality and justice in the taxation of utility companies through local assessors, and have conferred the power of assessing such companies upon some central board. In New York both state officials and other persons as well as organizations have continued to advocate that such assessment be taken from local officials and given over to a state board. The fourth State Conference on Taxation which met in 1914 at Syracuse adopted the following resolution: Whereas, The present system of the assessment of the real and personal property of railroads and other large corporations by local assessors imposes an unnecessary and difficult task upon such assessors and leads to inequitable results, and, Whereas, This method

of assessment has been abandoned in many other states, it is Resolved, That the laws should be so changed as to empower the State Board of Tax Commissioners, or experts employed by them, to assess the real property and other taxable assets of railroads and of large public service corporations operating in more than one tax district.

To establish a uniform system of taxing public utilities which will be just to the corporations and the public, equitable, easily administered and which will leave no room for evasion is a difficult task. A number of different systems have been tried with different bases for the tax but none of them has the unqualified support of every authority on taxation. That the New York system should be recast and improved, however, all agree, and we shall briefly note some possible alternatives or modifications.. The systems which have been most discussed are a gross earnings tax, a net earnings tax, and the more conservative method of maintaining some form of the ad valorem system.

New York at present, we have seen, uses gross earnings as a basis for part of the additional franchise tax. This basis for taxing corporations, and especially public service corporations, is at present widely advocated. Some of the advantages claimed for the gross earnings tax may be briefly summarized.

With gross earnings taken as the basis for taxes we do not find the difficulty of ascertainment as when net income is taken. There has been comparatively little dispute as to what constitutes the gross returns of a corporation, but difficulties have been encountered in apportioning this to expenses and net returns.³⁸ Any system of accounting will give the gross earnings and no question arises as to what items should be allowed. All items of expenses must be taken from the gross receipts, and it is not at all illogical to consider taxes an item of expense just as much as wages, rent, etc. The discretionary powers of officials can easily be dispensed with since there is little chance of manipulating the gross receipts statement

³⁸ This objection would have little weight in the case of New York since practically uniform accounting systems have been prescribed.

and the tax can be computed by simple mathematical calculation. Expenses of assessment and collection would likewise be reduced to a minimum, so the tax would "take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state." It conforms, moreover, more nearly to the American idea of a just base for taxation—property—than does net income. This sort of a property basis does not tax a concern until it has really been established upon an operating basis. The tax would fluctuate with business conditions; it would increase as business prospered and become a smaller burden in times of depression. It is a tax admirably adapted to meet the varying demands of the state since it can be easily modified, and will automatically increase with the prosperity of the state. The assessment upon which the property tax is levied, on the other hand, tends to become stationary. As previously pointed out, this has been particularly true in New York.

Some think that the gross earnings tax would work injustice particularly in the case of railroads. Many, however take the opposite view while a number of tax commission reports uphold such a tax. The Ontario commission in 1905, after making an exhaustive study of railroad taxation, said :

The gross earnings tax will cause no substantial inequality in the roads operating in Ontario, and as regards equality, there is little to choose between the gross and net basis. The choice would be determined on the ground of facility and certainty in ascertaining what is gross and net revenue. There is little dispute in determining gross revenue, while there is endless dispute in determining net, especially where it is to the interests of the company to minimize net earnings in order to escape taxation. There is no hesitation in selecting gross revenue as the simplest and most direct, and considering all the roads the most equitable basis of taxation. Earnings as a basis is fair because taxes vary with the capacity of a company to pay them whereas taxes on general property results in all manner of inequality. The amount of tangible property of various corporations has no necessary relation to their relative earning power and bears no accurate relation to the earning power of the same company at different periods. Only the tax on earnings follows automatically the capacity of the corporation to pay, and while it has its inequalities, it is much more equitable than any other practical system. The tax has the further advantage that all the processes connected with its operation are matters of public record. Thus the railroad on the one hand and the government

and public on the other may know exactly the basis of valuation, the rate of tax and the relative contributions of the tax payers in proportion to their business. Where the valuation depends more or less absolutely upon the opinion of one or two assessors who can not be quite sure of their own estimate either individually or collectively, it is obvious that the most unusual power without any adequate check is placed in the hands of one or two men. Where he has small properties to estimate and where each man's property was known to his neighbor this system had few difficult evils. But where railroads and other corporations the value of whose property is hardly known to themselves, are required to pay millions of dollars in taxes without any knowledge as to how their own or their rivals' assessments are made up, and where the public is necessarily in even more complete ignorance the opportunity and temptation is very great to bring influences to bear upon the government for the appointment of favorable assessors or upon the assessors themselves, for a favorable valuation. It is not in the interest of pure politics or sound finance, and it is certainly not fair either to the assessment boards or general public for a system of taxation to place such enormous interests as the value of many millions of corporate property in the hands of two men.

One of the most important advantages is that it does away with the difficulty of the taxing of franchises. Probably no aspect of modern economic wealth has given rise to such elaborate and confused discussion and even outlandish theorizing as the so-called "franchise" values. It is a confusion of the two economic phases in which "franchise" is used to indicate property value with the occasional introduction of legal aspects which has contributed so much to the darkening of counsel on the subject. Mr. Thomas F. Woodlock of Wall Street Journal reported to the commission that he favored a gross earnings tax. Then you cannot charge expenses for wholesale betterments, etc. It may happen that one road is compelled to operate at seventy five per cent of expenses and another at fifty, but the gross earnings are most suitable because easily ascertained. Mr. Hugh L. Bond, second vice-president of the Baltimore and Ohio Railroad, stated to the commission that he thought on the whole the most equitable basis for the taxation of railroads is the gross receipts.⁶⁹

This quotation, of course, applies in particular to a Canadian country but conditions there are not dissimilar to those found in New York. But we do not have to go to Canada to find the gross earnings system advocated and tried. The reports of the tax commissioners of both California and Minnesota heartily indorse it. The California commission in 1906 said that it would result in a closer approximation to justice than any other system which the state might select. The burden would vary with the fund out of which the taxes were to be paid.

⁶⁹ Report of Ontario Commission on Railroad Taxation 1905. Printed in State and Local Taxation, 1911.

Practical considerations naturally outweighed theoretical ones and the advantages of this tax were largely practical.⁴⁰ The Minnesota commission in 1910 pointed out that the greatest advantage of such a tax was the elimination of the necessity for valuing the complicated and peculiar properties of the corporation. Such valuations had been inaccurate and but crude guess work. To even approximate a fair value of such property required in each case the knowledge and skill of experts. A tax on gross earnings, moreover, not only rendered taxation a mere matter of mathematical computation, but gave to the system a desirable certainty and reliability. The method was the best yet suggested and the practical experience of a few years would fix a fair rate.⁴¹

In 1911 the Connecticut legislature appointed a committee to prepare a report on corporate taxation. This report was made in 1913 and, after a thorough examination of the other tax systems, recommended the adoption of the gross earnings tax. On pages 6 and 7 we find:

The tax on gross earnings avoids all the difficulties inherent in the tax on net earnings. No corporation can do business without having accounts which will at least show the amount of its gross earnings. Gross earnings are a definite fact, ascertained by a glance at the accounts, and incapable of argument or difference of opinion. The tax on gross earnings can be evaded only by perjury of the most obvious sort and capable of easy detection. The gross earnings tax, therefore, has the greatest advantage of simplicity, certainty, and ease of administration. This is an advantage both to the corporation and to the state. The amount of the tax on gross earnings fluctuates with the prosperity or adversity of the business and is therefore, just to all parties concerned. Moreover, it enters each year into the accounts in a definite ratio, and can thus be counted on in advance.

A serious question remains to be answered. Will not the tax on gross earnings be distinctly unfair on account of the great diversity between different corporations in their ratios of expense to earnings? The answer is that such injustices is to be avoided by classifying corporations according to the prevailing ratio of net earnings to gross, and imposing different rates upon the gross earnings of the different classes of corporations.

Investigation shows, for instance, that the ratio of net earnings to gross is fairly uniform for the railroads of the country. In the

⁴⁰ Report of California Tax Commission, 1920. Printed in State and Local Taxation, 1911.

⁴¹ Report of Minnesota Tax Commission, 1910. Printed in State and Local Taxation, 1911.

same way there is a general prevailing ratio of net earnings to gross for telephone companies, for express companies, etc. Having determined what this prevailing ratio is for each class of corporations we are enabled to fix ratios for each class which will make the tax on gross earnings just to all. It is true, of course, that absolute justice as between individual corporations of the same class is not obtained. The resulting injustice is, however, not great. . . . Some inequality is unavoidable but the inequality thus resulting is distinctly less than can be easily shown to result from any of the other schemes of taxation which are before us. No tax system can be absolutely perfect, and it is not a valid objection against a proposed scheme to point out a defect which is present in even greater degree in each of the other possible alternative measures.

We conclude, therefore, that the tax on gross earnings presents distinctively the most advantageous method for the taxation of public service corporations.⁴²

The commissioners continue, in this report, to show how the classification shall be made, how the ratio between gross and net earnings shall be determined, and give formulae for finding the proper rate to be imposed on the gross earnings. They hold that the rates should tax the different classes of corporations fairly as compared with the taxation borne by other forms of wealth.

Other reports have been favorable to the gross earnings tax and a number of states use it as supplementing other taxes. Different schemes, as suggested by the quotation we have just given, may be used to secure justice. If a flat rate on gross earnings be considered unjust, the remedy lies in classification of the corporations. No objection could be made to classification in New York since it is used in the present tax system. Classification may be on the basis of the enterprise, the relation of gross to net revenue, or both. In any departure from the flat rate great care should be taken that greater inequalities are not introduced than if a flat rate were maintained.⁴³

⁴² Report of the Special Commission on Taxation of Corporations, State of Connecticut, 1913.

⁴³ An interesting scheme for assessing the gross earnings tax has been proposed by Mr. Allen Ripley Foote, ex-president of the National Tax Association. He proposes a flat rate on gross operating revenue, plus a differential on the margin of difference between operating revenue and operating expenses. He would make this a substitute for all other kinds of taxes. Such a scheme, he thinks, combines both the principles of the property and income tax which would satisfy the advocates of each of these systems while justice would be given to the corporations. He proposes that a flat rate

In spite of this wide advocacy and apparent success of the gross earnings tax, we must admit that it has serious difficulties. Gross receipts do not represent earning capacity, and it is earning capacity that makes a concern valuable and able to pay taxes. It is what a concern has left after expenses are paid that spells success or failure. The gross returns of two street railway concerns for example, might be the same, while the net returns might be such as to make one a success and the other a failure. The one might be working under auspicious circumstances—short lines, heavy traffic, level streets, etc.—while the other would have the opposite conditions. Similar conditions are found in varying degree in all classes of public utility corporations and it is too much to suppose that any system of classification can properly take them into account. The tax, then, will to a greater or less degree be ununiform as between corporations, to say nothing of its relation to other taxes.

The experience of Michigan and Wisconsin, moreover, would tend to weaken our faith in the adequacy of the gross earnings tax. Both states have given it a thorough trial and have thrown it over-board. Wisconsin had the system for nearly fifty years, but gave it up in 1902. The reasons assigned by the officials of both states for this failure to give satisfaction were practically the same. Uniformity could not be secured between the corporations and there was no relation between the tax paid on corporate property and on other property. The governors under whose administration the gross earnings tax was given up, had pledged themselves to equality in taxation.

It is contended by some, however, that a tax based up-

of two per cent be assessed on the gross operating revenue of all corporations regardless of the margin of difference between their total revenue and total operating expenses. This is to be paid by all corporations whose operating expenses are ninety per cent or more of operating revenue. To this is to be added a differential of one-sixteenth of one per cent computed on each one per cent increase in the margin of difference between total revenue and total operating expenses in excess of ten per cent. Theoretically such a method would obtain a reasonable amount of justice, but the practical difficulties in determining the differential would no doubt defeat the end intended.

on net earnings will do more towards obtaining justice and equality than can a gross earnings tax. Net earnings can be used, either as the direct basis for the tax or as the basis for finding the value of the company. If the capitalized net earnings be taken as the proper valuation of a concern then no account need be taken of capital that may have been issued and squandered, the different forms of stock exchange manipulation or the watered stock a company may have. The factor under consideration is what the enterprise is worth as a productive agent or as a going concern. The original cost and cost of reproduction are not the controlling items which determine value; that is determined by the one characteristic—power to bring in a money return over and above expenses. The capitalized net income would most nearly correspond to what a purchaser would be willing to pay at a natural sale—and this the courts have held to be the value of property.

Mr. W. S. Stevens, a member of the New York Public Service Commission, expressed the opinion that the net earnings tax was the one tax that would have the support of basic principle. To quote:

An inquiry into the value of railroad property as a whole is an investigation of the question how much will any person or collection of persons desire to possess the property, and how much money or other things will they be willing to part with for the sake of such possessions. The difficulty attending the investigation is: 1. The property has never been bought or sold so there is no direct test or evidence of its ratio of exchange for money or other things; 2. It is not one of a class of things which is bought or sold with such frequency or under such circumstances as to afford a fair test of what it would be likely to bring upon exchange or sale. The only course open to the investor is to select those attributes which in his judgment would create a desire for the property, and then estimate how much that desire would induce a prospective purchaser to surrender for its satisfaction. Its one characteristic which gives it value is its supposed power to yield, directly or indirectly, a moneyed return equal to the investment with a profit thereon. Its value lies not in what it is but in what it will produce or what it is believed it will produce in money. This is the essential proposition upon which all depends. Generally speaking, what it will produce in money will depend upon its earning power, directly or indirectly. To the ordinary investor it is its direct earning power as shown by the excess of revenues over expenses. This fundamental consideration indicates that the net earnings rule, when properly and care-

fully applied with due regard to all the features of the individual case is probably the one having the surest support of basic principle. It is also the one which accords with the practice of shrewd, broad-minded and successful men of business.⁴⁴

In spite of the apparent logical and theoretical soundness of net earnings as a tax basis, many practical difficulties are met in its administration. One, which has proved most troublesome, is in determining the true net earnings. Accounting systems have been anything but uniform, and no comparison could be had between net earnings of different enterprises. This applies, however, with little force to New York since in recent years practically uniform accounting systems have been arranged for public utility corporations. Even with uniform accounting the difficulty might still remain of separating the earnings of the utility company from those of its investments or subsidiary undertakings. Neither would the system secure equality in assessment between public utility companies and other forms of taxable property. The difficulties which Wisconsin and Michigan found with the gross earnings tax would be magnified here. A man's farm and buildings are taxed even though they are producing no more than expenses. Yet a railroad with an investment of several million dollars would not be taxed until it became operative to the extent of having a surplus above expenses. Because of the fluctuation of earnings, the amount of the tax could not be counted upon as being in any degree stable.

The special commission which reported to the Connecticut legislature in 1913 in favor of the gross earnings tax characterized the net earnings tax as follows:

To avoid serious inequality and evasion the tax on net earnings would require for administration a thorough examination into the accounts of every corporation taxed, together with strict rules as to how these accounts should be kept. . . . It would be a continual source of irritation between the corporation and the taxing officials. It would involve the most disagreeable inquisition into the accounts and business of the corporations, and in the end there would still remain room for personal judgment, thus leaving open the door to political intrigue and corrupt influence. . . . The practical difficulties in the way of imposing a tax upon net earnings seem overwhelming. A further objection arises from the fact

⁴⁴ Quoted in *State and Local Taxation*, 1912, p. 194.

that a corporation might have no net earnings whatever in a given year, and therefore escape taxation entirely. While it is true that this might be perfectly just under a tax system based fundamentally upon income, we should bear in mind that the American tax system is today based upon property. The individual whose property has yielded him no income in a given year cannot offer that as a reason why he should not pay taxes upon his property. While the importance of treating corporations and individuals upon the same footing must not be stretched, there can be little doubt that a tax system which would allow corporations having no net earnings to escape taxation entirely would be out of harmony with the general tax system prevailing in America.⁴⁵

The objections to the ad valorem basis for taxing public utilities are due largely to misunderstanding of the term, and to the discrepancies which have arisen in attempting to apply different methods of valuation. As now used, an ad valorem tax means a tax based upon the value of a public utility as a piece of property rather than as divided up into different elements. The system further implies a more or less expert valuation of the corporation property by some centralized state board.

The discrepancies have arisen because of the limited powers of the assessors, or because too few factors have been taken into account in arriving at the valuation. One particularly troublesome feature has been to secure the value of the so-called franchise. The excess value of the stocks and bonds over the value of the real estate has been suggested as the value of the franchise. The average selling price of securities for a period of years is taken as the value. This is done in order to take account of any fluctuations due to seasonal disturbances or stock exchange manipulations. The greatest difficulty is perhaps in application. Thus the Michigan Tax Commissioners point out the difficulties which they encountered:

But as far as applying this theory to all the railroads in Michigan was concerned, it was found to be impracticable from the fact that the stocks and bonds of but comparatively few of the railroads were quoted in the market, that the stocks and bonds of many of the railroads were unknown to the open market, and the method could be applied only to the few railroads. Then, too, the computation of the bond value is rendered intricate and uncertain by reason of the fact that there may be several different issues of bonds issued by a company upon different portions of its line or upon the same por-

⁴⁵ Report of Special Commission on Taxation of Corporations, Connecticut, 1913. Page 35.

tion of its line; or the issue may have been made at a certain time covering the whole line, since which time the line may have been extended without it appearing how the issue is affected, or in what manner.

Another difficulty encountered in attempting to apply the stock and bond method in determining the value of railroads lies in the separation of railroad property devoted to operation from the property owned by the railroad but not used in its operation. The stocks and bonds of a railroad company represent the value of all the property of that company whether devoted to operation or not; manufacturing plants, mines, elevators, etc. . . . And when we consider, in addition to the intricacy and uncertainty of the computation of stock and bond values, the manipulation by stock brokers, regardless of the many conditions that affect the price or value of the stocks and bonds regardless of the real value of the property itself, we cannot but appreciate the incompetency and unreliability of the system.⁴⁶

This criticism is made to the application of the stock and bond method for valuing railroads but it is applicable in varying degree to public utilities. Administrative difficulties have likewise arisen in the attempt to find the value from earnings, initial cost, or reproduction cost. The item that is a determining factor with one concern may be unimportant for another. The report of the Connecticut Special Tax Commission which advocated the adoption of the gross earnings tax, characterized the ad valorem basis as follows:

To be properly performed it requires the work of a large force of experts familiar with the technical details of the business of the corporations concerned. At best the element of personal judgment is sure to enter. . . . Besides practical difficulties, important theoretical questions arise. In the majority of cases there is and can be, no such thing as an actual sale of the property of a public service corporation. The selling price is, therefore, unavailable as a basis of valuation. Shall the appraisal, then, seek to determine the original cost of the property or the cost of replacement, and if the latter, shall allowance be made for the present condition due to depreciation? Another difficulty with this method is its rigidity. Valuations when once made are very likely to remain for a considerable number of years without serious revision. This is caused partly by the very fact of the difficulty and expense involved in a thorough-going valuation. As a result, such valuations, no matter how successfully made at the start, very soon come to the unreliable.⁴⁷

We note, however, the attitude of Wisconsin, Mich-

⁴⁶ Report of Board of State Tax Commissioners, Michigan, 1909-1910. P. 55.

⁴⁷ Report of Special Commission on Taxation and Corporations, Connecticut, 1913, page 2.

igan, and Virginia to the ad valorem basis, we must question that it is wholly bad. Wisconsin, as we have seen, gave up the gross earnings tax in its favor and that, too, after the courts had stretched the constitution to declare the legality of the former. The attitude can be seen from the following extract from the report of the Wisconsin Tax Commission for 1910:

By substantially uniform ad alorem methods a nearer approach can be made to equality in tax burdens as between the different classes of public utilities, and as between them and general property, than seems practicable by resort to earnings as the basis of taxation. A tax based upon earnings at fixed rates involves the problem of ascertaining rates which are just and which will accomplish substantial equality of burden with property taxed by other methods. . . . In respect to most of the property employed in the various public service enterprises now under consideration such method seems fairly well adapted if the work of assessment is committed to officers having facilities for obtaining the necessary data and who are fairly qualified to make intelligent and impartial valuations.⁴⁸

The attitude of the Michigan Tax Commissioners is very similar to that taken in Wisconsin. In a report to the Governor in 1914, moreover, the Virginia Joint Committee on Tax Revision, after a careful analysis of different tax bases, says: "We believe that under an ad valorem system administered by a competent board untrammelled by any single prescribed standard or rule, it is easier to establish justice in taxation than under any other method."⁴⁹

It would seem, then, that the success or failure of the ad valorem tax to secure justice depends upon the competency of the assessing board, and the extent of power conferred upon it. We would consider it absurd to send a man or group of men to value a carriage who had spent their life as sailors. And we would consider it just as absurd to instruct men who were competent to determine the value of a carriage, to arrive at such value by taking into consideration only the wheels, or bed, or pole, or top. A particular carriage might have no top, or shafts instead of pole, or the wheels might be newly painted, so that no

⁴⁸ Report of Wisconsin Tax Commission, 1910, page 52.

⁴⁹ Report of the Joint Committee on Tax Revision, Virginia, 1914, page 138.

one of these could be taken as the determining factor in its value. Likewise they should be allowed to examine the spindles and tires to see how much they were worn—in short take all parts into consideration to determine its value. So, in finding the value of a public utility, not only must we have a competent board, but it must have broad powers. It must be allowed to consider all the factors which may contribute to its value—franchise, reproduction cost, earnings, etc. Not only must it be given power to consider all these items, but it must be given access to them. In order to efficiently carry on its work, the books, accounts, and records of the companies must be placed at its disposal. It should be empowered to examine witness and require reports—in short given every possible privilege which will enable it to make a proper valuation. Where we have this combination—a competent board with extensive powers—the prevalent objections to the *ad valorem* basis for taxation are greatly minimized.

A tax on earnings, moreover, is not such an out and out departure from a tax on value as it at first would seem. When we do not regulate the charges for services there may be no definite relation between the property in use by plant and its earnings; but we have adopted the policy of so regulating the charges made by public utilities that the net earnings shall represent but a fair return on the value of the enterprise. Of course there is no absolute rule for determining the value upon which earnings shall be allowed, and it is impossible to determine value so exactly or to fix rates so accurately in each particular case that a fair return will just be realized. But the more nearly this is approximated the more nearly will a tax on earnings correspond to one on value. It could make little difference in a case of perfect valuation and regulation of charges, where ten per cent were allowed as a fair return, whether ten percent of the net earnings were taken or one per cent, of the valuation. Because of the indefinite relation between net and gross returns, however, there could not be this close approximation between a gross earnings tax and a tax on value even if regulation

could be such as to allow just a fair return. Yet they more nearly correspond than under a system of no regulation.

Justice in tax reform is a relative rather than absolute expression. We cannot hope for absolute justice between corporations or between corporate property and other property. But there is no reason why it should not be more nearly approximated in New York than at present. The substitution of either an earnings tax or a tax on value, notwithstanding the difficulties connected with each, would prove more satisfactory than the present combination of franchise, earnings, and dividend taxes. Such action would mean a change from the present complexity to comparative simplicity. Corporations would at least know upon what they were being taxed, and could more nearly anticipate their tax burdens. Simplicity would bring intelligent publicity, with greater ease in obtaining justice among the public utility enterprises themselves, and between the taxes assessed to such companies and those laid upon other taxable property. Centralization of the assessing authority would facilitate checking up any discrepancies that might exist. In short, it would make for uniformity and fairness, and where this has been accomplished it has been found that corporation officials were willing to cooperate with taxing officials to secure efficient enforcement of the law.

If the system of taxing public service corporations for state purposes needs reform, the system for taxing them locally needs it doubly. The incongruities depicted by the Special Tax Commission in 1871⁴⁹ still remain. Reform might be secured by the entire abolition of local assessment of public utility property⁵⁰ if the localities could be made to see that, by so doing, they would not be the losers, and the legislators could be made to see that greater equality would be secured thereby. It would seem advisable that some centralized authority should have in charge, at least, the assessment of those companies whose plants extend into several districts.

⁴⁹ See above p. 126.

⁵⁰ This is of course on the assumption that the courts would uphold the constitutionality of such a change.

If some form of unit assessment, however, be adopted for determining the state taxes, reform in securing local revenue from these same enterprises could be accomplished with little added burden or expense. The amount intended for local purposes could be added to the state assessment and then distributed to the districts. The difficulty arises, of course, in choosing a basis for distribution. This could be made in proportion to the amount of trackage in the district, the amount of property located there, or the amount of business arising within its borders. From many standpoints the first of these has advantages. Where the business is greatest, the main lines are not only duplicated, but are supplemented by side tracks and switches. If it were considered that justice so demanded, the main lines and side tracks could be counted as having different importance.

Such allocation would rarely be needed except in the case of transportation and transmission companies. If a property basis were taken it would introduce the necessity for local valuations and the possibility for inequality. The tendency, no doubt, would be towards high valuation since the higher the value of the property in the district, the more tax it would receive.

Because, then, of the complexities of the present system of taxing public utility corporations, because of the discrepancies and inequalities which exist, not only between the different corporations but between the assessment of the corporate property and other property, we conclude that reform is needed. In the light of experience from other states we believe a unit method of assessment by central authority, either upon earnings or value, would be a marked advance over the present system. Finally, the system would more nearly approximate justice if the local revenue from public utilities were apportioned by central authorities to districts, perhaps on the basis of total trackage found therein.

CHAPTER VIII

THE SPECIAL TAXATION OF PUBLIC SERVICE CORPORATIONS

There is probably no part of the New York system of taxation which has been more widely discussed than the so-called "Ford Special Franchise Tax." Although Senator John Ford was sponsor for the statute, the person primarily responsible for its enactment was Theodore Roosevelt, then Governor of the State. In his first message to the legislature Governor Roosevelt condemned the existing system in general terms.¹ In his special message of March 27, 1899,² he went further, committing himself to a reform of corporate taxation:

It is true that a corporation which derives its powers from the state should pay to the state a just percentage of its earnings as a return for the privileges it enjoys. This should be especially true for the franchise bestowed upon gas companies, street railways and the like. The question of municipal ownership of these franchises cannot be raised with propriety until the governments of all municipalities show greater wisdom than has been recently shown in New York City. . . . I need not point out that in foreign communities a very large percentage of the taxes comes from corporations which use the public domain for pipes, tracks and the like. Whether these franchises should be taxed as realty; or whether it would be wiser to provide that, after the gross earnings equal, say ten per cent of the actual original cost, then five per cent of all earnings over and above this shall be paid into the city treasury; or whether some yet different plan should be tried can only be settled after a careful examination of the whole subject. One thing is certain, that the franchise should in some form yield a moneyed return to the government.

¹ Governor Roosevelt's Message, Jan. 4, 1899. With regard to taxation he said in part: "At present our system of taxation is in utter confusion, full of injustice and queer anomalies. . . . We should discourage the building up of non-taxable interests yet we should discourage driving property out of the state by unwise taxation or levying a tax which is in effect largely a tax upon honesty. I most earnestly commend the whole matter to your special attention."

² Governor Roosevelt's Special Message, House Journal, 1899, Vol. 2, p. 186.

Governor Roosevelt, in this message, suggested that there be some general scheme of taxation applying to all public service companies. He asked for a joint committee of the senate and assembly to investigate the subject in full and report to the next legislature. He asked for a legislative commission because, he said, it had been the almost universal experience that however excellent the reports made by special non-legislative tax commissions, the legislatures paid little or no heed to them. Shortly after this message was made public, Senator Ford introduced his bill for taxing franchises. The bill passed the Senate by the vote of 33 to 11. Strenuous opposition, however, developed in the Assembly, and Governor Roosevelt found it necessary to exert pressure to secure the passage of the bill. When it seemed on the verge of defeat he sent the following special message:

It appearing to my satisfaction that the public interests demands it, therefore in accordance with the provision of section 15, article 3 of the constitution and by virtue of the authority thereby conferred upon me, I do hereby certify to the necessity of the immediate passage of Senate Bill 1102 entitled, An Act to amend the tax law relating to the taxation of public franchises as real property.⁴

This message was not read in the assembly. As soon as the governor discovered this he sent another special message:

I learn that the emergency message which I sent last evening to the assembly on behalf of the franchise tax has not been read. I therefore send hereby another message upon the subject. I need not press upon the assembly the need of passing this bill at once. It has been passed by an overwhelming vote in the senate. A large majority of the assembly have signed a petition asking that it be put through. It establishes the principle that hereafter corporations holding franchises from the public shall pay their just share of the public burden. It is too late to try to amend or perfect the bill, even should such amendment or improvement be deemed desirable. It is one of the most important measures (I am tempted to say the most important measure) that has been before the legislature this year. I cannot too strongly urge its immediate passage.⁵

There could be no uncertainty as to the meaning of this message. On the last day of the session the bill was

⁴ Roosevelt's Message, April 27, 1899, Public Papers of Governor Roosevelt, 1899, p. 88.

⁵ Governor Roosevelt's Message to the Assembly, April 28, 1899, Public Papers of Governor Roosevelt, 1899, p. 89.

passed and then came before the Governor for his signature. Vigorous opposition developed and glaring defects were pointed out. The most weighty objections were, first, that local assessors could not approximate equality in assessing franchise and, second, that the addition of this tax to the special taxes already imposed by some municipalities on franchise would constitute heavy double taxation. Governor Roosevelt refused to veto the bill, thus allowing the matter to wait over until the next session of the legislature. Instead he called a special session to secure satisfactory amendments.

When the legislature convened the Governor sent it a lengthy message dealing with the matter. He reiterated much that he had said before, and again emphasized the importance of franchise taxation. He did not intend, he said, to oppress people who had put their money into the use of the city's or the state's real estate which made the franchise valuable. If it were worth little, it should be taxed little; if of great value it should be heavily taxed. He was convinced that the opposition to the bill before him, was directed not so much against its particular features as against the general principle of taxing franchises. Because of the determination of the interests affected to defeat franchise taxation, he deemed it necessary to secure statutory recognition of this principle at that session of the legislature. For this reason he justified his special message to which its passage was due. The bill as it stood represented a long stride in the right direction, and the ground thus gained must be held. In the essential feature—taxing franchises as realty—the measure was right. In two important particulars, however, he asked for amendment. One was to entrust the work of assessment to the State Board of Tax Commissioners; the other was to allow deductions for any franchise taxes paid a corporation to a municipality or other local unit. A few companies, he pointed out, already paid in this way as much as five per cent on gross earnings.⁶

That the legislature would adopt the proposed amend-

⁶ Governor Roosevelt's Message, May 22, 1899. Public Papers of Governor Roosevelt, 1899, p. 102.

ments was not a foregone conclusion. Some members of the legislature, including the author of the bill himself, objected to the amendments while others resented the use of executive pressure. Senator R. H. Mitchell probably expressed the attitude of a member when he said: "The governor is up against it. He issues an ultimatum to the legislature defining just what sort of a bill he will accept. I believe that a majority of the members of the legislature will go to Albany determined not to do what he demands just to show him that they, and not he, constitute the law-making power."⁷

But the real question before the legislature was not merely whether the law would be improved by the proposed amendments. The governor had made it plain that unless the amended bill were in his hands before May 27, he would sign the act as it was before him.

The amendments undoubtedly bettered the measure and to adopt them seemed the preferable alternative. This the legislature did May 26, 1899. That the Governor took upon himself the credit for the measure is plain from his utterance subsequent to its passage.⁸

The provisions of law⁹ are substantially as follows. Under the term land or real estate are included the value of all franchises, rights or permissions to construct, maintain or operate in, under, above or through the streets highways or public places. Such franchises are, for the purposes of taxation, to be known as special franchises, and are further defined so as to include the value of tangible property situated in such places and used in connection with a special franchise.

The Board of Tax Commissioners are annually to determine the valuation of each special franchise. They

⁷ *New York Times*, May 6, 1899.

⁸ In a speech at the Johnstown Fair he said: "..... the men in the legislature from whom I obtained the most aid in pushing through the franchise tax act..... It required boldness of action to get it through the legislature, but it could not be passed in any other way. The qualities of courage, of boldness and of common sense have got to be shown in passing any real legislative measure which has to meet a powerful opposition."—*New York Tribune*, September 7, 1899.

⁹ *New York Statutes*, 1899, Chap. 712.

must file with the clerk of the assessment district a written statement of this valuation, not less than ten nor more than thirty days before an annual assessment is to be made.¹⁰ Every company subject to such taxation must, within thirty days after each franchise is acquired, make a written report, under oath, to the state board. In the report is to be a description of the franchise, any obligation upon it and any other information the board may require.¹¹ The board meets at specified times to hear and determine complaints, with the provision, however, that such determinations may be reviewed through the courts. This law, then provides for a tax in addition to any previously existing tax, to be assessed upon the right to use a public thoroughfare and upon the fixtures found therein. Such property is considered real estate, is to be assessed by the State Board of Tax Commissioners, whose determinations are subject to court review. The law has been amended at minor points but its significant features remain unchanged.

This special franchise tax has been much discussed. The press was at first generally favorable to franchise taxation but was inclined to find fault with the Governor's methods of procedure, and there was not a little satirical comment on the predicament in which he found himself when he had forced the passage of a bill which he would not sign. Public sentiment was against the special session; it was thought that the Governor might better have vetoed the bill, and permitted the matter to wait over till the next regular session of the legislature. The special session was deemed a measure of political expediency,—to save the Governor from the humiliation of having to veto his own bill. But in its final form the act was given at the time the almost unanimous approval of the press of

¹⁰ The taxing officer of the district must furnish any information required by the State Board for the purpose of determining the value of the franchise. A copy of the valuation is to be delivered by the clerk to the assessors within five days after he receives it and they are to enter it upon the assessment roll.

¹¹ A penalty of one hundred dollars is imposed for failure to make any required report and in addition ten dollars per day for each day the failure continues.

the state and even of the country.¹² Tammany Hall sent to the Governor a memorial favoring the bill.¹³

One important feature of the law is its definition of special franchises as "real estate". This provision was made necessary because of the working of the general tax law under which corporations were assessed locally. In the assessments of personality debts were allowed to be deducted or "sworn off." Such could not be done, however, with the assessment of real estate. Under this law corporations had to a great extent escaped taxation upon their capital since the part covered by bonds was an indebtedness and could properly be deducted. Where the bonds equaled or exceeded the capital only the real estate was left to be taxed. Had the special franchise, then, been designated as personality, the purpose of the law would have been defeated to a great extent by the deduction of bonded indebtedness from the assessment. Senator Ford emphasized the importance of this feature: "The main virtue of the bill is that it proposes to tax these properties as real estate instead of as personality—that means that whatever tax the assessors levy must be paid. It cannot be 'sworn off' nor can indebtedness be offset against it. In other words the possessor of the

¹² The *New York Times* may be cited as an exception. From the beginning it criticised the principle of franchise taxation. *The Commercial and Financial Chronicle* took the same attitude as the *Times*. To quote from the *Chronicle* (*Public Opinion*, Vol. 26: 648) "The difficulty, it seems to us, lies deeper than any general question of how the law may be applied. The theory on which the entire measure is constructed is erroneous. A corporation franchise is not real estate and the briefest possible discussion of the bill has shown into what embarrassment and confusion the tax administration will be thrown by insisting upon such classification. The case simply amounts to this—that provisions framed for one purpose, and peculiarly adapted to that purpose, are suddenly and without substantial change, applied to something of a wholly different nature."

¹³ *New York Times*, May 12, 1899. In the memorial it was maintained that the bill was intended to remove inequality. It would reach the corporations who had special privileges taken by right of eminent domain. These privileges were to be the subject of taxation and such a law would mark a great advance in the New York system of taxation. The privileges should be taxed, it argued, since they are the most valuable part of the corporation property. Without them the rest of the property would be junk.

public franchise is placed in the same position, as far as the tax laws are concerned, as the owner of a house and lot, which property is taxed regardless of whether it is producing revenue or not and without regard to the mortgage that may be upon it, even though that mortgage covers eighty per cent of the total value of the property."¹⁴

The assessment and valuation of the special franchise has proved particularly difficult. The law as first passed by the legislature had left the assessment to local assessors, but in its final form this was given over to the State Board of Tax Commissioners. Senator Ford opposed the centralization of assessment, holding that, under a rule which he suggested, local assessors would have no difficulty in arriving at special franchise valuation.¹⁵ The law prescribed no particular method of assessment, such matters being left to the discretion of the tax commission. Before beginning its work the commission asked the Attorney General for an opinion as to the method of procedure. This was given by Mr. J. Newton Fiero, counsel designated for the purpose, September 28, 1899.

The purpose of the act, he thought, was to subject certain classes of franchises, and those only, to assessment; it did not give the right to assess a corporation for the privilege of exercising its right to exist as such, or for its good-will, or on the choice or conduct of its business. He reviewed the New York court decisions relating to the valuation of corporate property and franchises as well as the systems of valuation used by other states. Some of these, he pointed out, would be in harmony with New York decisions.

He concluded that the practical and practicable method of arriving at the entire value of assets with a view to assessing the special franchise necessitated a consideration of the cost of the real estate, and of the earning capacity of the property as a whole. As elements going to

¹⁴ *New York Times*, April 30, 1899.

¹⁵ The rule suggested by Senator Ford was practically the stock and bond method of valuation. The difference between the value of the stock and bonds, and the reproduction cost of tangible assets would represent the value of the public and special franchises.

make up such values by showing earning capacity, the value of the capital stock, surplus, and bonded indebtedness must also be considered. In addition all circumstances which tend to enhance or depreciate the value of corporate property had to be taken into account. A consideration of such factors, modified in each case to suit the circumstances, would give the value of the entire corporate property.

When this value is determined, however, the problem is by no means solved. The only assessment to be made was of the "special franchise" together with the "value of the tangible property" used in direct connection with it. Obviously deductions from the entire corporate value were necessary. Indebtedness could not be allowed to lessen the assessment since the special franchises were classed as real estate, from which deductions of indebtedness were not permitted. Real estate, however, which was not included in the statutory definition could not be assessed as a part of the special franchise, and its value must be deducted from the entire value of the corporation's property and franchises. The value of the tangible and personal property, likewise, it was necessary to deduct. Besides these items the general franchise to be a corporation had a distinct value, as well as the choice, conduct, and good will of the business which values could not be included in the special franchise. In short, all the property which did not come within the definition of a special franchise must be deducted from the total valuation.

From these considerations he concluded that "the value of a 'special franchise,' therefore, is arrived at by ascertaining the value of the entire corporate property, taking into consideration all the elements which go to make up such value, and deducting therefrom the value of the personal property of the corporation, of so much of the real estate as is not connected with the special franchise, and of the franchises not affected by this amendment, in fine, by deducting from the total value of corporate assets all the intangible and tangible property not part of, or connected with, the special franchise."

Mr. Fiero admitted, in the conclusion of his report, the leeway the proposed method left to the tax commissioners, particularly in determining the value of the good will, conduct of the business, franchise to be a corporation, and the value of the intangible franchise not taxable. It was impossible, he thought, to adopt rigid rules of valuation for property the value of which depended on so great a variety of elements. Such rules could only be general in character and must be subject to modification in individual cases. Because of the wide discretion necessarily vested in the assessing officers, absolute certainty in values would not be possible.

The Board of Tax Commissioners had to contend at first with many difficulties, and to encounter much criticism. Frequent inquiries were made as to what rule was followed in making a special franchise assessment and the reply that it was impossible to use any one rule was naturally not deemed satisfactory. The Board, in fact, found it next to impossible to perform the duties required of it. The task of placing a value upon every railroad and trolley crossing, and every use of the streets and highways by other public service corporations involved an enormous amount of labor. In order to facilitate assessments the legislature, at the request of the board, eliminated from the special franchise class all uses of public thoroughfares less than 250 feet in length.¹⁶ This reduced the number of special franchise assessments by about 1100 and the valuation by more than \$10,000,000. But it was not long before the Tax Commissioners pointed out the enormous value attached to short crossings in populous centers, and asked that the amendment be modified. The 250 feet exemption reduced the revenue and involved an unjust discrimination.¹⁷ The legislature accordingly included in special franchises all uses of public thoroughfares in cities and incorporated villages and placed the assessment under the jurisdiction of the State Tax Commissioners.¹⁸

¹⁶ New York Statutes, 1901, Chap. 490.

¹⁷ Annual Report of Board of State Tax Commissioners, 1906.

¹⁸ New York Statutes, 1907, Chap. 720.

In spite of the difficulties in administering the tax, the commissioners approved it as a matter of justice and as a source of increased public revenues. Valuations of corporate properties were greatly increased. The total value placed upon the special franchises of New York City at the first assessment was nearly \$290,000,000. The special franchises of some individual companies are found to be enormously valuable. For the Metropolitan Street Railway system this value was over \$55,000,000; for the Consolidated Gas Company, over \$10,000,000; for the Third Avenue Street Railway system over \$17,000,-000. General approval, of course, attended such results of the law.

This statute, however, has been the cause of an enormous amount of litigation. Values were, of necessity, arbitrarily determined, and this opened the door for complaints. The constitutionality of the law was first attacked. In 1903 the Court of Appeals defined a special franchise as "the right granted to a corporation to construct, maintain or operate, in a public highway, some structure intended for public use, which, except for the grant, would be a trespass." It was contended that the home-rule provision of the constitution¹⁹ was violated by placing the assessment of special franchises in the hands of the State Tax Commissioners. This contention was rejected by the court, which held that the statute created a new system of taxation, and brought within its range a new character of property which required new methods of valuation. With this the exercise of new functions arose which had never belonged to local assessors. The functions were properly committed to state officers whose

¹⁹ Article 10, Section 2. This provides that "all city, town and village officers, whose election and appointment is not provided for by this constitution, shall be elected by the electors of such cities, towns, and villages, or of some subdivision thereof, or appointed by such authorities thereof, as the legislature shall designate for that purpose." The court held that when this provision was invoked in relation to taxation it should be considered in connection with the supreme taxing power of the legislature and neither should be construed so as to embarrass or cripple the other. The right to create a new system of taxation and bring in property of a new character could not be decried upon this principle and should not be withheld from the legislature.

duty related to the subject of taxation in all its phases throughout the entire state and who, with wider experience and greater opportunities for observation than local assessors, would be able to grasp the new scheme of taxation as a whole. Such action, moreover, would be free from all local prejudices of color. Other contentions, to the effect that the act was impracticable and incapable of execution, and that this was evidenced by the failure of the commissioners to adopt a definite rule in making the assessment, were likewise overruled.²⁰

A number of cases involving the methods used in making the assessments have come before the courts. That of the Jamaica Water Supply Company was the most important. We have already noted the method suggested by the court for valuing corporate property.²¹ The net earnings basis, it will be remembered, was adopted. To determine the value of a special franchise the court would have the assessors first deduct operating expenses from gross earnings. A reasonable return upon the portion of the capital invested in tangible property was also to be deducted. The capitalized remainder would represent the value to be attributed to the special franchise. Taxes, except the special franchise tax, were to be deducted from gross earnings in determining net earnings as well as a proper amount of depreciation. In absence of evidence to the contrary, six per cent was to be taken as a fair rate of return in calculating the value of a special franchise. The court recognized that the rule was not infallible, but thought it could be generally applied. If the calculations left no value for the special franchise, it would be conclusive reason for rejecting the net earnings rule and would demand the adoption of some other method of valuation.

It appears, that in laying down this rule, the court took no account of the fact that other franchise values besides the special franchise have to be reckoned with. The other franchises, to be sure, are not taxed locally yet the total

²⁰ *Metropolitan Street Railway Company vs Tax Commissioners*, 174 N. Y., 417. Affirmed 199 U. S., 1.

²¹ *Jamaica Water Supply Company vs Tax Commissioners*, 196 N. Y. 39. See preceding chapter, p. 134.

value of all franchises cannot properly be imputed to the so-called special franchises. The rule suggested gives at best merely the whole franchise value and suggests no scheme by which the assessment can be divided into sums representing the values of the different kinds of franchises. Neither does it suggest any method by which the value of one special franchise may be separated from the value of other special franchises. A railroad company, for example, may have special franchises in a number of tax districts and it is necessary to assign separate values to the franchises in each district. It would seem, then, that the suggested rule fails to solve the problem of special franchise assessment, and that as much leeway as before is left to the tax commissioners.

Judge Blackmar, in a later case,²² discounted the importance of the net-earnings rule in special franchise valuations. He admitted, of course, that the most important single element in determining the value of a special franchise is the earning capacity of the company. But no thoughtful appraiser, he held, would deem the results of the business for a single year conclusive without a consideration of many other matters. The real value of a special franchise does not depend upon what it does earn, but upon what it can be made to earn. This would be the way a person who contemplated purchase would value it. Here, then, we have another basis, one which the judge himself characterizes as attended by too many complications to be of direct practical use. This factor, however, he thought should be given due weight. That none of the methods used were altogether satisfactory is indicated by the number of cases that continued to come before the courts.

The corporations were severely, and perhaps unfairly, criticized for contesting the law. *The Independent* attributed the opposition of the "interests" to Roosevelt's second term as governor to this law. "But his franchise tax law," it said, "was so strongly affirmed that it could not be shaken, and efforts to escape its requirements will

²² *Queens County Water Company vs Woodbury*, 67 Miscellaneous, 490.

do the companies more harm than good. The tax is clearly a just one. Great quantities of stock and bonds have been issued upon franchise privileges rather than upon actual cash. By means of such manipulation large fortunes have been acquired." To such practices it attributed the clamor for municipal ownership of public utilities.²³ Such were the opinions of the press generally, which seems to have endorsed Roosevelt's statement that the principle had come to stay. Governor Odell, however, favored the repeal of the law because of its indefiniteness and the consequent litigation. He recommended the gross earnings tax as a substitute.²⁴

One obvious defect in the law was its failure to provide for the equalization of assessments, which had to be made by the board at full value. In the Jamaica Water Supply Company case, cited above, the court held that the State Board of Tax Commissioners had no power to reduce the value of a special franchise for purposes of equalization. Reduction could only be made by the courts where such property had been assessed at higher proportionate value than other property on the same tax roll.

During the first eight years that the law was on the books, less than half the taxes due on special franchise assessments were paid, pending the outcome of legislation. The Tax Commissioners had from the first asked for the power of equalization and the Court of Appeals had recommended that such power be conferred. The State Conference on Taxation held in Utica in 1911 unanimously adopted a resolution recommending the equalization of special franchise assessments by the State Board. Governor Dix in his message of 1911 referred to the enormous amount of litigation and asked for an amendment that would permit the tax commissioners to make an equalized assessment. Such an amendment to the law was finally passed in 1911.²⁵ The State Board

²³ *The Independent*, May 7, 1903.

²⁴ Governor Odell's message to the Legislature, 1903, Public Papers of Governor Odell, 1903, p. 12.

²⁵ New York Statutes, 1911, Chap. 804.

now attempts to equalize special franchise assessments with real estate assessments in each district.

In 1911, 975 writs of certiorari were taken out in the courts for the review of special franchise assessments. In the following year, with the amendment in force, the number fell to 212. But this number is so large as to indicate that the operation of the law is still far from satisfactory. Cities and towns have begun action in cases where they thought the Commissioners under their equalization powers had unduly reduced special franchise values. The possibility of inequality still exists in the attempt to equalize the special franchise value to the percentage which the assessed value of other real property in each district bears to its full value: It is difficult for the commissioners to determine just what is the relation between the assessed and full value of other real property in the various districts.

The board of tax commissioners expressed the hope that the equalizing of the special franchise valuations would largely aid in bringing local assessments of real property up to the full value standard. The reduction of the special franchise valuations²⁶ brought forcibly to the attention of the people the rate at which real property was generally being assessed, and the loss that came to the particular tax district by reason of assessments being lower than full value. When an adequate force of appraisers was supplied, the Board expected to be in possession of sufficient information to make plain to the assessors the extent to which they were violating the law. The Commissioners recognized that the assessments in many localities were unequal, but they lacked positive proof of such inequality and undervaluation.

Taken as a whole, the statute has proved in operation to be one of the most arbitrary and complicated parts of New York's already far too complex system of taxation. The different methods and "rules" suggested for valuing the franchises, and the admitted impossibility of framing

²⁶ As given by the tax commissioners in their report for 1912, the total valuation of special franchise for 1912 was \$601,988,675 and the equalized valuation was \$533,790.692.

a "rule" fitting all cases, points to the conclusion that the fair and equitable assessment of special franchises is an impossibility. The net earnings basis of valuation and its difficulties have been discussed in the previous chapter. Just what are net earnings? What shall be allowed for expenses in each case, and how shall the rate of capitalization vary for the companies operating under different conditions of hazard? What has been the character of the management in this or that particular case and what allowance must be made for managerial ability in making the assessments? Railroads in the streets are a greater hinderance to public use than are gas mains, telephone conduits, etc., and yet there are many cases in which larger profits must be imputed to the latter. Are the commissioners to use the same rule and basis of capitalization for all companies? How much of the earnings is to be attributed to property located outside the streets? Are the prices which some corporations pay municipalities for their franchises, either in a lump sum or annually, to be taken into consideration? What part shall the fee value of the land itself occupied in the streets have in the assessment? What place must be given to the possibility for future earnings? How determine the value to a railroad company of the right to cross the street in a country village of 1000 population?

Problems such as the above questions suggest and many others arise under the application of the law, and with a slightly different application in each case. And when we consider that there are nearly 8000 special franchises annually to be assessed and equalized with the assessed value of other real estate in the district where the franchise is situated, we must grant the utter impossibility of satisfactory results. Instead of making the tax system more simple and uniform, as had been urged by the reformers, it has piled complexity upon complexity. It has increased revenues in some places, but at a waste of time and money in administration and litigation. And all this has not afforded uniform and just treatment to the corporations, for under the statute it is virtually impossible to treat all alike. The assessment must be arbi-

trary and the companies have no way of knowing in advance how much their taxes will be. It also increases the burdens connected with the mere payment of the taxes. That such burdens are not inconsiderable is shown by the fact that some corporations pay as many as 5000 separate tax bills.

But was there really no justification for the measure? It was, of course, an attempt to make the property basis of taxation more adequate in reaching corporate value. The people saw companies which held gratuitous long-time or perpetual franchises and from which they were coining money, and on which they were paying little or nothing in taxes. The very idea of the public franchise, in so far as it means a franchise to serve the public, seemed to be forgotten, and the idea that such a franchise conferred the right to exploit the public seemed to be in vogue. And in a number of cases there were facts which went far to justify such an interpretation of the situation.

It was to have been expected, of course, that franchises granted by the public without special safeguards for the public interests would be exploited as they were. When the people realized the value of these special grants and sought to correct the evil they had brought upon themselves, no weapon seemed so readily available as taxation. If the special franchise tax could be made to take the earnings of exploitation and be kept uniform and fair in its application, there could be little objection to it. But even though we justify the special franchise tax as an attempt to take the "earnings of privilege," the difficulties are not cleared away. It still remains to account for the "additional franchise taxes" upon the gross earnings and dividends of some classes of public service corporations. Then, too, the inadequacy of the annual franchise tax to reach intangible values, in the cases where it applies, must be explained.

The modern interpretation of the idea covered by the term "public franchise" is not that the franchise gives a corporation the right to use public property for the purpose of gaining an income from it. It is rather a privilege granted to the corporation to use such property in

rendering a public service. The service is not expected to be rendered without compensation and the public must allow a reasonable return on the capital used to render such services, but not on the value of a free gift from the public. A public franchise cannot be capitalized against the public. But, in fact, many corporations were getting more than the public was willing to allow and the taxation of surplus profits was the first remedy hit upon. More recently, however, a better and saner method of establishing just relations between the public and the corporations has been introduced. This is regulation by a public service commission. This commission has the board powers of deciding upon a fair return on capital invested, quality of service, and the rates to be charged. Under regulation the values now represented by special franchises tend to disappear. If regulation were perfect there would be no special franchise values. Since it can thus deal with the use of franchises, the question of taxation resolves itself into this: are public service corporations to be viewed as existing for the benefit of the users, the community viewed as a body of taxpayers, or both? If for the former then the commission will require low rates, and there will be nothing left (over a fair return) for taxes; if for the state, then higher rates with some curtailment in the use of the utility; if for both, moderate rates with only a moderate surplus for taxes.

Under a system of perfect regulation there is no doubt that, if the public service corporation pays a tax, it merely acts as a collector of that tax from the public. The net earnings of a company must be large enough to allow a fair return. In ascertaining the net earnings, taxes, along with the operating expenses, are deducted from gross receipts. If there were no tax the total income of the company could be reduced by the amount of the tax and their net earnings remain unchanged. With the tax the charge for service must be such as to allow a fair return after its deduction from gross receipts.²⁷ For this reason many

²⁷ This is only necessarily true under regulation. A tax imposed upon a monopoly where prices were fixed so as to bring the highest net return might have no effect, or one not in proportion to the tax, on the price charged for the service. Rates would still be such as

persons now favor the abolition of special taxes upon public utility corporations for these increase the burden upon the consumer of the service. Such taxes are, more or less, according to the utility in question, a burden upon a particular class. A tax upon street railways, for example would be borne in large part by the middle and lower classes. In the case of some other utilities, steam heat or gas, for example, the opposite may be more nearly true.

Because of the necessary burden a tax places upon the consumer of a public utility service, some have advocated the entire abolition of taxes upon this class of enterprises. Such action would secure cheaper services but at a higher tax upon other assessable property. It would practically amount to shifting such tax to the owners of other property.

Under regulation, public utility property becomes much like other property so far as a means for raising revenue is concerned. It is property yielding a fair return, and so should neither be freed from taxes nor have special taxes applied to it. The most logical and just method of procedure, it would seem, would be to tax such property valuations to the same extent that other property is taxed, and in such a way as to equalize the burdens on this class of property and other property. The proceeds could be applied to the needs of the state, the locality, or both. Such a tax, however, should not be assessed under the guise of a special franchise tax, for this has proved complex and confusing. We conclude, as in the preceding chapter, that the present system should be simplified into some uniform tax, assessed by a central board. Some inequalities, no doubt, would exist until proper regulation and assessment is secured. Such, however, would tend to disappear with time and experience. Simplicity would at least be secured and no greater injustice or inequalities would be incurred than exist at present.

to bring the largest net return to the company, and it is possible they would remain the same as before the tax was imposed.

CHAPTER IX.

SUMMARY OF NEW YORK LAWS TAXING CORPORATIONS.

I. FOR STATE PURPOSES.

A DOMESTIC CORPORATIONS.

ORGANIZATION TAXES (Section 180) Every stock corporation incorporated under any state law must pay a tax of one-twentieth of one per cent upon the authorized capital stock. A like tax is imposed upon any subsequent increase of capital stock. The minimum tax is five dollars. Banks, building, mutual loan, accumulative fund and co-operative associations are exempt from the tax. Railroads need not pay when incorporated but must pay before they receive a certificate from the public service commission. In case of consolidation the tax must be paid only on the capital in excess of the amount which has previously borne the tax.

ANNUAL FRANCHISE TAX. (Section 182) Every corporation, joint stock company, and association, for the privilege of exercising its corporate franchise, must pay an annual tax on the amount of capital employed within the state during the preceding year. The amount of stock employed within the is the same proportion of the issued stock as the gross assets employed in the state bear to the entire gross assets. If the dividends amount to six or more per cent upon the par value of the stock the tax is one-fourth mill for each per cent of dividend so declared.

If the dividends amount to less than six per cent and (a) the assets do not exceed liabilities, exclusive of capital stock, or (b) the average price at which the stock sold did not equal or exceed par, or (c) if no dividends were declared, the tax is three-fourths mill per dollar on capital employed in the state. If the dividends have been

less than six per cent and (a) the assets exceed liabilities exclusive of capital stock, by as much as the par value of the stock or (b) the average selling price of the stock during the year was as much as par, the tax on capital employed in the state is one and one-half mills per dollar. The valuation of the capital cannot be less than (a) the par value of the stock, (b) the difference between assets and liabilities, exclusive of capital stock, or (c) the average price at which the stock sold during the year. Where there are two kinds of stock paying dividends at different rates, each kind of stock is taxed as if it were the only taxable stock. Any corporation not taxable under the above provisions is taxed not less than would be produced by a tax of one and one-half mills per dollar on the actual value of the capital stock employed in the state or on the average price at which stock sold during the year.

Some corporations are exempt from the annual franchise tax. (Section 183) These are banks, savings banks, institutions for savings, title guaranty, insurance or surety corporations and trust companies. Laundering, manufacturing and mining companies are exempt if at least forty per cent of the capital stock is invested in property in the state and used in laundering, manufacturing or mining business. Agricultural and horticultural associations and companies owning or operating elevated railroads, surface roads not operated by steam, and companies formed for supplying water or gas, for electric or steam heating, lighting and power purposes are also exempt from the tax.

ADDITIONAL FRANCHISE TAX: (Section 184) All steam surface railroad companies and all canal, steamboat, ferry, express, navigation, pipe line, transfer baggage express, telegraph, telephone, and palace or sleeping car companies must pay an annual excise tax or license fee of five tenths of one per cent upon gross earnings within the state. The earnings considered are those arising from business originating and terminating within the state. Earnings from interstate commerce are therefore excluded. Ferry companies operating between the boroughs of

New York city under a city lease are not subject to the tax.

OTHER TAXES ON TRANSPORTATION AND TRANSMISSION COMPANIES: (Section 185 and 186) Companies owning or operating elevated railroads or surface roads not operated by steam must pay an annual tax of one per cent on gross earnings derived from all sources within the state. In addition they must pay three per cent upon the amount of dividends declared or paid in excess of four per cent on the actual amount of paid up capital employed. Companies formed for supplying water and gas or for electric or steam heating, lighting or power purposes, must pay an annual tax of five-tenths of one per cent on gross earnings derived within the state. Besides this they must pay a tax of three per cent upon the dividends declared in excess of four per cent on the actual amount of paid up capital.

INSURANCE COMPANIES: (Section 187) All insurance companies organized or formed under a general or special law of the state must pay a tax of one per cent on the gross amount of premiums received during the year. The gross premiums include all premiums received on all policies, certificates, renewals, policies subsequently canceled, insurance and reinsurance during the preceding year, and on all policies issued in all years prior to the preceding year.

TRUST COMPANIES AND SAVINGS BANKS: (Section 188 and 189) Every trust company operating under any law of the state must pay for the privilege of carrying on its business in such organized capacity an annual tax of one per cent on the amount of its capital stock, surplus and undivided profits. Savings banks must pay for the privilege of exercising corporate form, an annual tax of one per cent on the par value of surplus and undivided earnings.

STOCK TRANSFER TAX: (Section 270) A tax of two cents on every \$100 face value is imposed on all sales or agreements to sell or memoranda of sales of stock. The person making the sale must affix and cancel the stamps to pay the tax. Stamps are prepared by the State Com-

troller and their sale is limited to banks organized under the New York laws, under the national banking act or to a duly authorized agent of the Comptroller. Penalties are imposed for failure to pay the tax, failure to cancel stamps, illegal use of stamps and for failure to register.

B. FOREIGN CORPORATIONS

LICENSE TAX: (Section 181) Foreign Corporations, for the privilege of carrying on business in a corporate capacity in the state must pay a license fee of one-eighth of one per cent on the amount of capital stock employed within the state during the first year of carrying on business. Any subsequent increase of capital employed in the state is subject to the tax. The amount of capital employed in the state is taken to be such part of the issued capital stock as the gross assets employed in any business within the state bear to the total gross assets. The State Tax Commission fixes the amount of capital upon which the tax is to be paid. Banking corporations, fire, marine, casualty and life insurance companies, co-operative fraternal insurance companies and building and loan associations are exempt from the tax.

ANNUAL FRANCHISE TAX: (Section 182) Foreign corporations pay the annual franchise tax on the amount of capital employed in the state. The tax is computed in the same way as the tax on domestic corporations. The amount of the stock upon which to compute the tax is determined by the proportion of assets found in the state.

FOREIGN INSURANCE COMPANIES: (Section 187) All insurance companies formed under laws of any other state of the United States, except fire and marine insurance companies, pay one per cent of the gross amount of annual premiums. All insurance companies organized under laws of foreign countries, except those doing a life, health or casualty business, pay one per cent on the gross amount of annual premiums. The tax on fire and marine insurance companies organized under the laws of a foreign country, however, is five-tenths of one per cent of the annual premiums. If any state imposes heavier taxes

upon a New York company than normally imposed in New York, companies from that state are taxed to the same extent as are New York companies during business there.

TAX UPON FOREIGN BANKERS: (Section 191) Every foreign banker doing business in the state is required to pay an annual tax of five per cent on the amount of interest or compensation earned or collected on money loaned, used or employed in the state.

OTHER TAXES FOR STATE PURPOSES: All companies paying the above taxes, except the organization tax, are exempt from assessment and taxation upon their personal property for state purposes. (Section 205) Since there is a small directly apportioned tax for state purposes a part of this falls upon corporations since their real estate is legally assessed for state purposes. Very little personal property is assessed since provision is made only for placing real estate and capital stock on the assessment roll. According to the statute none of the locally collected tax, except real estate taxes, could be taken for state purposes.

II. FOR LOCAL PURPOSES

(Sections 11 and 12) Real estate and personal property of corporations is to be assessed and taxed by local assessors. Real estate is taxed at situs while personal property is taxed at the place of the principal office. In the instructions for making out the assessment roll, however, provision is made only for placing on the roll real estate and capital stock.

TAXATION OF BANKS: (Section 24) Bank shares are to be assessed to the holder at the place where the bank is located. The assessment and taxation is not to be at a greater rate than is made or assessed on moneyed capital in the hands of individual citizens of the state. The value of shares is found by adding together the amount of the capital stock, surplus and undivided profits and dividing the result by the number of outstanding shares. When a bank is in liquidation the value is found by divid-

ing the actual assets by the number of shares. Individual bankers must report the amount of capital invested in the business and have it assessed as personal property. The tax upon bank shares is one per cent of the value. No deduction is allowed for the personal indebtedness of the share holders.

SPECIAL FRANCHISE: (Sections 43-49) The use of public property to the extent of 250 feet or more in length, and any use in a city or incorporated village, is assessed and taxed as real estate. Valuations are made and equalized by the State Board of Tax Commissioners. Taxes which companies already pay for the use of public property are deducted from special franchise assessments.

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